TO: San Diego Audit Committee

CC: Files

FROM: Willkie Farr & Gallagher LLP

RE: Interview of Keri Katz on June 20, 2006

DATED: August 11, 2006

On June 20, 2006, Sharon Blaskey, in Willkie Farr & Gallagher LLP's capacity as counsel to the Audit Committee, interviewed Keri Katz. Johnny Giang and Tammie Davis of KPMG were present for this interview via telephone, and I attended the interview in person. Ms. Katz was not represented during this interview. The interview took place in a conference room on the third floor of the City Administration Building in San Diego. The interview lasted approximately one hour.

The following memorandum reflects my thoughts, impressions, and opinions regarding our meeting with Mr. Mullen, and constitutes protected attorney work product. It is not, nor is it intended to be, a substantially verbatim record of the interview.

Warnings

Ms. Blaskey informed Ms. Katz that she represented the Audit Committee, not Ms. Katz and was going to ask her questions related to the City's setting of its sewer rates. Ms. Blaskey told Ms. Katz that notes would be taken during this interview which would be used to draft a memorandum summarizing the interview, but that these notes and memorandum would be attorney work product and not available to witnesses to view or comment upon. Ms. Blaskey told Ms. Katz that the Audit Committee controls any privilege that applies to this interview, and any such privilege might be waived when the Audit Committee communicates with other entities, or makes its report or interview summaries public. Ms. Blaskey asked Ms. Katz to keep the contents of this interview confidential. Ms. Blaskey asked Ms. Katz if she had any questions, and Ms. Katz wished to note for the record that she was not accompanied by an attorney for this interview.

Background

Ms. Katz joined the City Attorney's Office (CAO) at the same time as City Attorney Casey Gwinn (1996-2004), and began working in the Criminal Division where she stayed for one year. She then switched her practice area, first to civil torts and land use, then to construction litigation, and then to construction advisory before becoming the Head Deputy of the Public Works Unit. Ms. Katz is currently legal counsel to the Mayor. Ms. Katz could not remember the exact dates during which she worked for the Public Works Unit, but noted that she

was at the CAO the entire time City Attorney Gwinn was there, and became legal counsel to the Mayor two or three months into the Mayor's tenure.

As Head of Public Works, Ms. Katz advised the engineering and capital projects departments, which she called her "client." She also supervised the other members of the CAO's Public Works units, such as water, sewer, engineering and capital projects, environmental services, and others. Ms. Blaskey asked Ms. Katz if, in this capacity, she advised the wastewater department. Ms. Katz replied that she advised the engineering and capital projects department, and supervised the Assistant City Attorneys working for the wastewater department. She mentioned Kelly Salt, Ted Bromfield, Tom Zelaney and McGinnis (phonetic), as examples of attorneys she supervised, which she said totaled about twenty-five people at any time.

Wastewater

Ms. Blaskey asked Ms. Katz if she was familiar with the City Attorney's Interim Report regarding Wastewater. Ms. Katz said that she was familiar with the report and had read parts of it, but had no involvement in its preparation. Ms. Blaskey asked who she reported to at the CAO, and Ms. Katz replied that she worked for Anita Noone.

Ms. Blaskey asked Ms. Katz when she first became familiar with Proposition 218 as it applied to sewer rates. Ms. Katz said she had no recollection of when she first became aware, and said that the law came down and it involved sewer and water, but also many other units. She recalled that there were issues regarding Proposition 218 after it was passed, but could not recall any specifics of these issues.

Ms. Katz explained that Ted Bromfield was the head of the water and wastewater departments at the CAO and was her boss when she began working at the CAO. She said that he reported to the wastewater department staff, attended meetings, and was responsible for giving legal advice to the wastewater department. Ms. Katz stated that Mr. Bromfield "did his own thing" at the CAO, referring to his work with the water and wastewater departments.

Ms. Blaskey asked how Mr. Bromfield's work differed from Kelly Salt's practice. Ms. Katz said that Ms. Salt performed some work alongside her, but Ms. Salt also worked on other financings for various units. Ms. Katz said that Ms. Salt billed twenty percent of her time to wastewater and was responsible for the bond offerings related to capital improvement projects. Ms. Katz said that Mr. Bromfield was the person responsible for providing any other legal or financial advice to the wastewater department.

Ms. Blaskey asked if either Mr. Bromfield or Ms. Salt supervised the wastewater department regarding sewer fees, and Ms. Katz answered that they did not. Ms. Katz said that the sewer fees issue was raised in meetings, like any other issue, and that the wastewater department said that it was working on it. Ms. Katz stated that only if there was a problem, would it have been brought to her attention; otherwise, she was not involved in the sewer fees issue on a daily basis. Ms. Katz stated that the City was involved with rate setting and Cost of Service Studies about every three years. Ms. Blaskey asked if Ms. Katz recalled learning about the City's need for a proportionate rate structure. Ms. Katz replied that there were always issues of allocation with the water and wastewater departments, but that she did not recall any specific issue. She noted that, in City Attorney Aguirre's Interim Report on Wastewater, there was an

issue raised concerning a Cost of Service Study and whether the City's disclosure met certain requirements. Ms. Blaskey asked Ms. Katz what she knew of this issue other than what she read in the City Attorney's Report, and Ms. Katz replied "just bits and pieces."

Documents

Ms. Blaskey showed Ms. Katz a memorandum from Ted Bromfield to "File," dated December 22, 1999 (Exhibit 1), which referenced a meeting between Bromfield and Ms. Katz. Ms. Katz said she believed this was an exhibit in the City Attorney's Interim Report. Ms. Blaskey asked if she recalled receiving this memorandum at the time it was sent, and Ms. Katz said she did not. Ms. Blaskey asked if she recalled meeting with Councilmember Christine Kehoe regarding the Cost of Service Report and Proposition 218, and Ms. Katz replied that she did not remember a meeting with Councilmember Kehoe, but said that she was sure that if there was a problem regarding this issue that she would have been called to a meeting to discuss it. Ms. Blaskey asked Ms. Katz if she remembered Councilmember Christine Kehoe raising questions regarding Proposition 218. Ms. Katz said that she remembered Councilmember Kehoe's concerns from reading subsequent reports, but did not recall from her own memory. Ms. Katz said that if Bromfield wrote that Councilmember Kehoe had requested an opinion on sewer rates, it was "clear she asked for it."

Ms. Blaskey showed Ms. Katz an email from Ted Bromfield to Casey Gwinn, on which she was copied, dated November 24, 1999 (Exhibit 2), and asked Ms. Katz if she knew the "Chris" and "Craig" referenced in the email. Ms. Katz said that the email referred to Councilmember Christine Kehoe and Craig Adams. Ms. Katz said that, at the time of the email, she would have known of the reference to Councilmember Kehoe, but would not have known Craig Adams, who she guessed was a staff member. Ms. Blaskey read from the email that Mr. Bromfield wrote, "[a]lthough I have a firm opinion on [Proposition] 218, I agree we don't need to opine now as 'proportional' billing is required by revenue guidelines imposed on the City as a result of our grant receipts." Ms. Blaskey asked Ms. Katz if she recalled having knowledge of this issue, and she replied that she did not. She said that, at that time, Proposition 218 was not a "big issue." Ms. Blaskey asked why Ms. Katz was copied on this email, and she replied that it was "standard procedure" for Bromfield to copy others on his emails. Ms. Blaskey noted that Ms. Katz followed-up on Bromfield's email with an email of her own dated March 22, 2000 (also Exhibit 2), stating "what ever happened with this?". Ms. Katz said that she did not have a specific recollection of her reply email, and stated that she sometimes went through her emails and checked-in with her to-do list.

Ms. Blaskey asked if Councilmember Kehoe's concerns ever resulted in a project for the CAO, or if there was a resolution of the matter. Ms. Katz replied that she had no specific recollection of the response to Councilmember Kehoe's concerns. Ms. Katz stated that she had no recollection of another Cost of Service Study that was performed, and said that she had no involvement at all in the Cost of Service Study process.

Ms. Blaskey asked Ms. Katz if she followed California decisions on Proposition 218. Ms. Katz said that she did not, and that she relied on Kelly Salt, who kept an up-to-date notebook on Proposition 218 issues. Ms. Katz said that Proposition 218 involved other units of the CAO and that there was a MCLE (continuing legal education in California) on this topic.

Ms. Blaskey showed Ms. Katz an email from Kelly Salt to Ms. Katz and a number of other recipients in the Auditor & Comptroller's Office, the City Manager's Office, the CAO, and Paul Webber, dated October 18, 2001 (Exhibit 3), and asked her to read it. Ms. Blaskey asked if Ms. Katz recalled an issue in Fall 2001 about lifeline rates and whether discounted rates for low-income individuals were permissible under Proposition 218. Ms. Katz replied that lifeline rates were often an issue, though she recalled this issue pertaining to water, not sewer rates. Ms. Katz said that she knew the CAO dealt with lifeline rates, but had no specific recollection of Exhibit 3.

Ms. Blaskey asked Ms. Katz if she knew Dennis Kahlie (Utilities Finance Administrator) and if she worked with him on sewer issues. Ms. Katz said that she knew Kahlie, but did not work with him on sewer issues. She stated that she went to meetings with him, and if "something was going bad," she would return to the CAO staff and provide an independent analysis of the troublesome issue. Ms. Katz said that she had a specific recollection of Kahlie on an unrelated issue, but not relating to lifeline rates and Proposition 218. Ms. Blaskey asked Ms. Katz to describe her role in meetings with City employees, and Ms. Katz said that she was brought into meetings if there was a disciplinary problem or a dispute. She said that there was no set process for her involvement, and a request for her intervention would usually take the form of a phone call from the City Manager or department staff who were unhappy with a Deputy City Attorney or were concerned the CAO's services were being billed correctly. Ms. Blaskey asked if Ms. Katz received complaints about CAO staff, and she responded that she did. She said that she "absolutely" received performance complaints about Kelly Salt, but none regarding Proposition 218 or compliance issues. Ms. Katz remembered that she received complaints regarding bond offerings, because Salt was "putting up a fight" and telling the City to do something it did not want to do. Ms. Katz said that she saw emails between Salt and Mary Vattimo in which Salt was "being difficult." She said that Salt and Vattimo were friends, but there were tough times at the end of their City careers. Ms. Blaskey asked if their disagreements were personal or legal. Ms. Katz said that their problems were both personal and legal, and that they did not see "eye to eye." Ms. Katz said that she remembered being involved in their disputes, but did not recall the specific topics at issue. She said that both Salt and Vattimo were "strong-headed," and they brought Ms. Katz in to mediate their dispute. Ms. Katz said that she believed the CAO cut back on Salt's work, and brought in other CAO attorneys to help.

Ms. Blaskey asked if Ms. Katz sensed that there were differing opinions in the City regarding how much or what information to disclose to the public. Ms. Katz replied that she did not recall disagreement on the legal issue of how much information to disclose, or on other "black or white" issues, but she recalled ongoing issues, disputes, and tension with the way disclosures were handled. Ms. Blaskey asked, with respect to bond offering disclosure, whether Ms. Katz believed that Ms. Salt would have been in favor of disclosing information, or would have been more conservative in this judgment. Ms. Katz said that she had the sense that Ms. Salt could have been more conservative. Ms. Katz said that she was not a bond attorney, but knew that there was tension around Mr. Webber, and she had the sense that Ms. Salt and Mr. Webber were pushing in one direction and City staff were pushing the other way.

Ms. Blaskey showed Ms. Katz an email from Kelly Salt, dated January 18, 2002 (Exhibit 4). Ms. Katz said this email was a segue to a closed session presentation in January 2002, and noted that Ms. Katz did not appear in closed session documents in that timeframe.

Ms. Katz said that she would have known that the Council had met in closed session because there were distributions of closed session reports. She said that sometimes she saw these reports and other times the distribution went to Les Girard. Ms. Katz stated that she did not recall a January 2002 closed session about the City's noncompliance with requirements regarding its sewer rates. Ms. Blaskey said that Ms. Katz was not on the list of attendees for the January 2002 closed session, and Ms. Katz said that she would not have attended or made a presentation on the issue of lifeline rates and Proposition 218 because she was not the subject matter expert on this issue.

Ms. Blaskey asked Ms. Katz if she attended a closed session presentation in which Ms. Salt and Mr. Kahlie discussed sewer rates and Proposition 218 and the City's need to comply with state regulations. Ms. Katz said that she did not recall attending this presentation or hearing of it, and it did not stand out in her mind. Ms. Blaskey asked Ms. Katz whether, if Ms. Salt knew that the City was not in compliance with grant and loan covenants and that there were possible ramifications as a result, Ms. Salt would have discussed such an issue with her. Ms. Katz replied that she recalled Ms. Salt bringing issues to her, but did not think that the compliance issue was one of them. Ms. Blaskey asked if Ms. Katz learned at any point that the City had exposure to the repayment of grants and loans. Ms. Katz said that, at the time, she knew there was an issue, but did not appreciate the extent of any exposure, and also said that she did not know at the present time that the City had exposure to the repayment of grants and loans. Ms. Katz noted, however, that she had not had time to read the City Attorney's entire report on wastewater.

Ms. Blaskey asked Ms. Katz if she was aware of a November 2002 memo that laid out the City's potential liability under its grants and loans for its noncompliant sewer rate structure. Ms. Katz said that she did not recall seeing that memo, although she said that it was possible she could have seen it. She noted that certain items were routed through supervisors, but said that she was not an expert in this area. She said that Ms. Salt, Mr. Bromfield, and, to some extent, Mr. Girard, were involved in bond offerings. Ms. Katz said that she had twenty-five people reporting to her and did not have time to delve into all issues.

Ms. Blaskey asked Ms. Katz to explain the CAO's process regarding the review of closed session memoranda. Ms. Katz said that every memorandum had its own process. She said that closed session memoranda came in red folders with a routing slip, which would have sent the memoranda to a Deputy City Attorney, then to either (but not both of) Ms. Katz or Mr. Bromfield, then to Anita Noone, and then to Mr. Girard. Ms. Blaskey asked what Mr. Girard would do with the memoranda once he received them. Ms. Katz said that he would edit them, depending on the time he had available. She said that everyone to whom the memoranda were routed had the right to edit their form, but not their substance. Ms. Katz said that, by the time a memorandum was circulated, the attorneys were only looking at its form, not substance.

The Natural Resources and Culture Committee

Ms. Blaskey asked Ms. Katz to explain the role of the Natural Resources and Culture Committee ("NRC"). Ms. Katz said that she was a legal advisor to the NRC regarding the Brown Act, and was responsible for making sure the attorney handling a given matter was present at the appropriate meetings. She stated that the NRC was a standing committee whose members used to be appointed by the Mayor, but was now filled by the Council President. Ms.

Blaskey asked if the NRC would hear discussion on sewer rates. Ms. Katz said that the NRC would sometimes hear sewer rate discussion, other times the discussion would go straight to the full Council, at the discretion of the NRC Chair. She noted that different committees sometimes overlapped in subject matter.

Ms. Blaskey asked if Councilmember Donna Frye served on the NRC, and Ms. Katz replied that she did. Ms. Blaskey asked if Ms. Katz recalled exchanges with Councilmember Frye in which she requested information regarding a Cost of Service Study. Ms. Katz said that she was positive that Councilmember Frye had asked for this information and had felt that her request was not responded to quickly enough. Ms. Katz said that Councilmember Frye brought up the issue of sewer rate compliance.

Ms. Blaskey asked if Ms. Katz recalled discussing with Councilmember Frye her frustrations regarding her access to Cost of Service Studies. Ms. Katz said that she did not recall having any such discussions, but recalled there was a tension between Councilmember Frye and the City Manager's Office because she wanted to receive the Cost of Service Study faster. Ms. Katz said that she got the impression that Councilmember Frye thought the City was "sitting on it [the Cost of Service Study]," and she was concerned about citizens being overcharged.

Ms. Blaskey asked Ms. Katz if she recalled that the effect of implementing the changes recommended by the Cost of Service Studies would be a shift in the allocation of rates. Ms. Katz said that she did recall this, and that this effect was common knowledge. She said that she probably knew at the time whose rates would have risen and whose would have gone down, but did not recall at present. Upon being told that homeowners' rates would have gone down and business' rates would have increased, she said this was indicative of the classic tension between businesses and small homeowners. Ms. Blaskey asked Ms. Katz if she was ever asked to opine on allocation issues, or on how to resist increasing industrial rates. Ms. Katz said that she was not asked this because she was not the expert on these issues. She said that she did not recall if Ms. Salt opined on this issue, or if Ms. Salt discussed this issue with her. Ms. Katz said that it seemed as though there was "tension" on this issue and that the CAO was in the middle of it.

Noncompliance with Grant and Loan Covenants

Ms. Blaskey asked Ms. Katz if she recalled reading a memorandum drafted by Kelly Salt regarding the City's noncompliance with its grant and loan covenants. Ms. Katz said that it was possible that she had read this memorandum, but had no specific recollection. Ms. Blaskey asked if she had a general recollection of learning that the City faced potential ramifications for its noncompliance. Ms. Katz said that she knew the grants and loans were a problem, but did not recall any discussion that the City would face significant financial exposure. Ms. Katz said that she did not have a specific recollection of how she came to learn of the City's noncompliance. She said that she finally put it all together when she read the City Attorney's Wastewater Interim Report. Until that time, she said that was only involved in certain aspects of this issue, and that this was only "one of a hundred issues" she was dealing with.

Ms. Blaskey showed Ms. Katz an email from Dennis Kahlie to herself and others, dated March 6, 2003 (Exhibit 5), regarding the CAO's response to Councilmember Kehoe's request for information regarding Cost of Service Studies. Ms. Blaskey directed Ms. Katz to a portion of the email where she outlined a procedure for dealing with Councilmember Kehoe's

request. Ms. Katz said that she did not recall this email, but stated that sending emails like this one was something she would have done as part of her normal duties. She further stated that once she would have received the information requested, she would have given it to Salt and the NRC, because she would not have wanted to contact only one member of the Committee. Ms. Katz noted that in this particular case, only Councilmember Frye had requested information, but it was her practice to respond to the whole Committee. Ms. Blaskey asked if Ms. Katz was the person to whom Council members would turn for information on this issue, and she responded that they would have gone to Kahlie; Ms. Katz said that she was only the conduit for the Council members to receive information. Ms. Blaskey asked Ms. Katz if she recalled speaking to Salt about Councilmember Frye's request. Ms. Katz said that she had no such recollection, and although she probably would have copied Salt on her response to Councilmember Frye, she had no specific recollection of doing so.

Ms. Blaskey directed Ms. Katz to the last page of Exhibit 5, which referenced a May 1, 2002 Black & Veatch Cost of Service Study. Ms. Blaskey asked Ms. Katz if she knew that a draft Cost of Service Study had been given to the Council, and Ms. Katz replied that she did not know. She said that she did not know if this study was discussed in NRC, but noted that it would have been unusual for a draft to have been circulated yet not discussed at the following NRC meeting.

Ms. Blaskey showed Ms. Katz an email she wrote to Ms. Salt, dated November 7, 2003 (Exhibit 6), which referenced a meeting of the Public Utilities Advisory Commission ("PUAC"). Ms. Blaskey asked Ms. Katz if she recalled a Cost of Service Study being sent to PUAC, and she replied that she had no specific recollection, but taking such a study to PUAC would have been the normal process. Ms. Blaskey asked Ms. Katz if, at that time, she felt there was a compliance issue for the City. Ms. Katz responded that she probably thought there was a compliance issue, and stated that PUAC was usually the last step before an issue was brought to Council. In this case, Ms. Katz stated, PUAC would have seen the Cost of Service Study and would have made a recommendation to the Mayor and Council. Ms. Blaskey asked if, at that time, Ms. Katz thought that there was an issue regarding compliance with State law or covenants and Ms. Katz said that she did not. She said that she remembered these issues generally, but did not specifically remember the issue of compliance with State mandates.

Ms. Blaskey asked if PUAC was looking at one specific issue, or was examining the whole Cost of Service Study. Ms. Katz said that she was sure there was a particular issue at stake because everyone was anticipating the Cost of Service Study and the City Manager decided to take it to PUAC because it was controversial. Ms. Blaskey asked if there was a subcommittee of PUAC formed to address the Cost of Service Study, and Ms. Katz said there was and this was an unusual procedure. Ms. Blaskey asked if there was a usual circumstance under which a subcommittee was formed, and Ms. Katz said that there was not. She said that PUAC had standing subcommittees, which were appointed by the PUAC Chair, who himself was appointed by the Mayor.

Returning to Exhibit 6, Ms. Blaskey asked Ms. Katz if she recalled a meeting with Richard Mendes regarding an upcoming closed session. Ms. Katz said she had no specific recollection of any such meeting, but said that it was possible the Cost of Service Study was discussed in closed session because of a litigation risk.

Ms. Blaskey showed Ms. Katz the agenda for the November 17, 2003 PUAC meeting (Exhibit 7), and asked Ms. Katz if she recalled this meeting in which Mr. Kahlie gave a presentation on the Cost of Service Study, and she presented the legislative update (as noted on the agenda). Ms. Katz said that she would have been at the meeting the whole time. She said she did not specifically recall this meeting.

Ms. Blaskey showed Ms. Katz an email from Kelly Salt to her, dated November 21, 2003 (Exhibit 8), regarding a request by Kelco for information from the City, and asked whether she recalled Kelco conducting its own analysis of the Cost of Service Study. Ms. Katz said that she knew that Kelco had hired its own lobbyist, Doug Sain. She recalled Mr. Sain because he was a Council liaison for the NRC, but did not recall Mr. Opper, who was also mentioned in the email, or Kelco. Ms. Blaskey asked if Mr. Sain was a former City employee, and Ms. Katz said that he was, and that he worked as a liaison to the NRC. She said that Council members were appointed to the NRC, and they appointed a committee consultant to run the committee, which was Mr. Sain. Ms. Katz said that he was now a private consultant, and she believed that Kelco had been his only client at the time of the email. Ms. Blaskey asked if Mr. Sain had ever contacted her, and she responded that she could not recall but was sure that he had. Ms. Katz said that he would have complained about Ms. Salt, and that she would have told him to "back off." Ms. Blaskey asked Ms. Katz what kind of complaints he would have made, and she said that she did not recall specifics, but Kelco wanted its way on everything and "put their hands on" Council. She said that Kelco wanted its rates to be lower and were lobbying heavily to that end. Ms. Katz said that Kelco would have complained that Ms. Salt was uncooperative if it would have helped its lobbying efforts. Ms. Katz said that several City matters affected Kelco, and it lobbied heavily on all of them.

Ms. Blaskey directed Ms. Katz to an email from Mr. Sain (third page of Exhibit 8) dated November 21, 2003, discussing Chemical Oxygen Demand ("COD"). Ms. Blaskey asked Ms. Katz if the COD requirement was a big issue in discussions with Kelco. Ms. Katz said that she remembered COD was an issue, but did not recall it being a "big" issue from the City's perspective. She said she had a general recollection of Kelco's lobbying efforts, but was not the person who dealt with these issues. She said that Bromfield or Salt handled this matter, and would have given her only general progress updates, not consultations on substantive issues.

Ms. Blaskey showed Ms. Katz an email from Dennis Kahlie to herself and Ms. Salt, dated December 5, 2003 (Exhibit 9). Ms. Blaskey read Ms. Katz the first paragraph of the letter, and asked whether it refreshed her memory that the City received a demand letter from the State to incorporate COD. Ms. Katz said that she had no specific recollection, but was sure that the City had received such a letter. She said that the City received SWRCB (State Water Resources Control Board) letters often, and she did not remember this one in particular being a big issue. Ms. Blaskey stated that this particular letter from the SWRCB implicated hundreds of millions of dollars in borrowed funds, and Ms. Katz said that it was not on her "radar screen." Ms. Blaskey then stated that the SWRCB had told the City its loans and grants were at risk. Ms. Katz replied that the SWRCB had said this earlier also, and had been saying it for years. Ms. Blaskey asked Ms. Katz if she was familiar with Participating Agency issues, and Ms. Katz said that she did not recall these issues and that Bromfield would have been responsible for them.

Ms. Blaskey showed Ms. Katz an email she wrote to Dennis Kahlie dated December 5, 2003 (Exhibit 10), in which she instructed Mr. Kahlie to work with Ms. Salt to

respond to the SWRCB demand letter issue. Ms. Katz said that she delegated this issue to Ms. Salt and that "this is not my issue."

Ms. Blaskey showed Ms. Katz an email from Kelly Salt to herself and Mr. Girard dated December 8, 2003 (Exhibit 11), and read Ms. Katz a portion of the first paragraph dealing with a closed session memorandum detailing the City's compliance requirements. Ms. Katz said that she had no recollection of this issue or memorandum. Ms. Blaskey asked why Ms. Katz was copied on emails from Ms. Salt to Mr. Girard, and she replied that she was involved because the City Manager's Office was upset with Ms. Salt. Ms. Katz said that she got this sense from previous emails. She said that Mr. Kahlie spoke with the City Manager's Office often and was "always there," and he wrote to Mr. Mendes when he was upset. Ms. Katz said that mediating these disputes was her role.

Ms. Blaskey asked Ms. Katz if she recalled anyone in the City being surprised by the City's noncompliance. Ms. Katz said that her impression from reading these documents was that the City was just not complying. She said that this was "typical;" the City would often ask the departments to do certain things and they would not. Ms. Blaskey read Ms. Katz a sentence from Exhibit 10 that, "Dennis has informed me that John Kern has indicated that he doesn't want this to go to Council until after the primary." Ms. Katz said that she had no recollection of this, but said that it would not have surprised her because it was politics and was not pretty. Ms. Blaskey read that "because of pressure from Kelco and the restaurant lobby, the council may shift more of the cost on the base rate." Ms. Blaskey asked if this statement was consistent with Kelco pressuring the City. Ms. Katz said that it was.

Ms. Blaskey showed Ms. Katz an email from her to Ms. Salt and Mr. Girard, dated December 8, 2003 (Exhibit 12), regarding the City's noncompliant sewer rate structure. Ms. Blaskey asked Ms. Katz if she spoke to Salt about whether the City was in compliance with grant and loan conditions. Ms. Katz said she did not have a distinct recollection from this email, and did not recall any other conversations with Ms. Salt on this issue. Ms. Blaskey asked Ms. Katz if her impression after reading this email was that Ms. Salt believed the City was out of compliance. Ms. Katz said that she did have this impression, and that she recalled having this impression at that time, but other than the email, she could not recall why she had that belief. Ms. Blaskey asked Ms. Katz if she had a "heightened sensitivity" to these issues after this email, and Ms. Katz replied that she probably did. She said that this issue went to Council and the rates were changed accordingly, so she would have thought this issue was taken care of.

Ms. Blaskey showed Ms. Katz an email from Mr. Bromfield, dated June 2, 2004 (Exhibit 13), stating that Mr. Girard had drafted a "scripted motion for the Mayor to direct the Manager to study and return with 'Kelco' options." Ms. Katz said she did not know to what the term "Kelco options" referred, but said it sounded like Kelco made a proposal to the City.

Ms. Blaskey showed Ms. Katz an email from Les Girard, dated June 2, 2004 (Exhibit 14), and asked if there was a sense that Mr. Girard "took the lead on everything" (as he suggested in the email). Ms. Katz said that there was such a sense. Ms. Blaskey asked Ms. Katz to explain Mr. Girard's role regarding disclosures. Ms. Katz replied that she did not know his role, but knew that Ms. Salt reported to him regarding disclosure issues. She said that Mr. Girard would have been involved at the end of the process when things were finalized. Ms. Blaskey

asked whether Council members treated Mr. Girard as the "go-to guy," and Ms. Katz said that Council relied on Mr. Girard, who was, among other things, a Council Liaison.

Ms. Blaskey asked the representatives from KPMG if they had any questions, and they responded that they did not. Ms. Blaskey asked Ms. Katz if she had any questions, and she responded that she did not.

W.F.G.

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EXHIBIT 1

Office of
The City Attorney
City of San Diego

MEMORANDUM

DATE: December 22, 1999

TO: File

FROM: Ted Bromfield

SUBJECT: Ms. Kehoe's Request for 218 Analysis on the Cost of Service Report

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Ms. Kehoe requested a legal opinion on whether the conclusions of the Cost of Service Report show a violation of Proposition 218. Her request was made on November 3, 1999, and the City Attorney requested a response by November 17, 1999.

On November 15, 1999, I prepared both an eight-page Memorandum of Law and a two-page response, both confirming no Proposition 218 violation. However, due to the sensitivity of the 218 analysis and the City Manager's pending update of the Cost of Service Report, the Office decided a meeting with Ms. Kehoe would be preferable.

On November 24, 1999, Keri Katz and I met with Ms. Kehoe and her assistant, Craig Adams, and presented the issues. We mutually agreed that a formal legal opinion would not be necessary but a timeframe for the Manager's update was needed. I communicated this need to Deputy City Manager George Loveland, who promised such a timeframe. As of this date, the Manager has been unable to supply a timeframe. Hence I have reminded him by e-mail (attached).

TB:mb
Attachment

EXHIBIT 2

Email message text
Object type: [GW.MESSAGE.MAIL]
Item Source: [Sent]
Message ID: [3A0E6B50.Demo-dom.Demo-PO.100.16E696E.1.F0.1]
From: [Keri Katz]
To: []
Subject: [Fwd: Ms. Kehoe's Request for 218 Opinion on Sewer Rates]
Creation date: [3/22/2000 12:01:01 PM]
In Folder: [Mailbox]
Attachment File name: [E:\Output\KKatz1\296.1-GW.MESSAGE.MAIL]
Message: [
WHAT EVER HAPPENED WITH THIS???
I have not heard a peep!

]

From: Ted Bromfield
To: Casey Gwinn
Date: Wed, Nov 24, 1999 9:50 AM
Subject: Ms. Kehoe's Request for 218 Opinion on Sewer Rates

Hope Texas and turkey are treating you well: Just an update on the above. Keri and I met with Chris and Craig Adams on 11/24 to discuss her request. I pointed out the City' s 1999 Official Statement (pp. 37-38) on sewer bonds and the uncertainty of the application of 218 and suggested that since Cost of Service Report is being updated, then brought back to NRC, that is the time to have a full debate on the "fairness" of rates. Chris agreed that we could respond to her memo in that fashion with one addition of when Manager would be doing that. Hence I will check with the Manager and draw up a response conforming with same. Although I have a firm opinion on 218, I agree we don't need to opine now as "proportional" billing is required by revenue guidelines imposed on the City as a result of our grant receipts. Of course, I will circulate my reply through the Red Folder. T.

CC: Jim Chapin, Kelly Salt, Keri Katz, Theresa McAteer

EXHIBIT 3

289628
Wastewater hot 03_01_06

Email message text
Object type: [GW.MESSAGE.MAIL]
Item Source: [Received]
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From: [Kelly Salt]
To: [;Ed Ryan;EXR.Auditor.cab7-9;Dennis Kahlie;DKahlie.fm.cab7-9;Mary Vattimo;MVattimo.fm.cab7-9;Casey Gwinn;CaseyGwinn.City_Atty.CCP;Keri Katz;KKatz.City_Atty.CCP;Ted Bromfield;TBromfield.City_Atty.CCP;George Loveland;GLoveland.MANAGER.CCP;Patricia Frazier;PFrazier.MANAGER.CCP;Pwebber@orrick.com;internet:Pwebber@orrick.com;Scott Tulloch;WST.MW_DEPT.MWWD;Bill Hanley;WZH.MW_DEPT.MWWD]
Subject: [Re: SEWER COST OF SERVICE STUDY AND PROP 218]
Creation date: [10/18/2001 11:44:58 AM]
In Folder: [Sewer]
Attachment File name: [c:\44923\MVattimo\8797.1-MOL-2001-15.wpd]
Message: [
Dennis, this e-mail is in response to your inquiries regarding the application of Prop 218 to our sewer rates and is intended to clarify the position of our office on these issues. By memorandum dated July 31, 2001, a copy of which is attached, we recommended that the MWWD comply with the noticing provisions of Article XIIID of the California Constitution (commonly referred to as Prop 218) for the implementation of its sewer rate increases. Although we are of the opinion that our sewer fees and charges are not property-related fees and charges subject to the provisions Prop 218, we recommended that the City comply with the noticing provisions until a definitive case determines that sewer fees that are consumption-based are not property-related fees and charges.

As discussed on pages 2, 26-27, and 29-30 of the MOL, the reason we recommended compliance with Prop 218 is that the City is proceeding with additional bond issuances for the sewer program. If our rate structure is legally challenged for non-compliance with Prop 218, the City could become entrenched in protracted litigation, thereby delaying the imposition of the rate increases. Those rate increases are essential to our ability to service the debt on the bonds. Additionally, if the City's rate structure was legally challenged we would have to disclose the challenge to the bond market. Such disclosure could have a negative impact on any future or outstanding bonds. Bond counsel has further advised us that we would have to disclose non-compliance with Prop 218 even if there is no legal challenge to the rate structure. This also could have a negative credit impact on the bonds.

Having provided this analysis, I would note that the MOL also indicates that ultimately the City will have to decide how it wishes to proceed on these matters. It is a policy decision.

I would also note that the question presented in the MOL concerns, in part, whether the City should comply with the noticing provisions of Prop 218 for the increase of its sewer fees and charges. However, the analysis is not limited to the noticing provisions of Prop 218, but applies to all of its provisions. In other words, non-compliance with any provision of Prop 218 could result in a legal challenge to our sewer rates and affect future or outstanding bonds.

Having identified the risks associated with non-compliance and making our recommendation, I would note that the MOL also indicates that ultimately it is a

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policy call as to whether the City complies with the provisions of Prop 218 respecting its sewer rates (page 30 of the MOL). We decided to comly with the noticing provisions of Prop 218 for the last sewer rate increase. We have been advised that the Council may be interested in creating a separate class of customer under the sewer rates for low income custormers (i.e. lifeline rates). Such lifeline rates do not comply with Prop 218.

Before such a rate structure is brought forward to the City council, we would recommend that the prospect of potential litigation regarding such a rate structure and its associated risks be discussed in closed session. Having apprised the Council of the risks associated with implementing the rate structure, they can decide as a matter of policy whether they want to assume the risks.

Please let me know when it is timely to bring this to closed session. We are happy to work with you in preparing the closed session memo. Additionally, please do not hesitate to contact me if you have any other questions.

>>> Dennis Kahlie 10/17 11:56 AM >>>
Learned Counselors,

In the course of yesterday's adoption by the City Council of MWWD's requested series of four annual 7 ½ % increases in revenue beginning next March 1st, much interest was shown in the results of the ongoing sewer cost of service study, sewer capacity charge levels, and the establishment of a residential sewer "lifeline" rate; all of these are impacted to some degree by our approach to dealing with Prop 218.

We've thusfar taken the position that while we don't believe 218 applies to sewer rates, we're going to proceed as though it does. We do this because we're a big agency worth suing, we're in the debt market every couple of years, there's no appelate court decision specifically exempting sewer fees from 218, and we don't want to be the poster child for litigation in the midst of a bond issue. This position makes perfect sense, but we've all got to sing from the same hymnal on this issue, particularly in terms of addressing the upcoming "lifeline" issue.

The Mayor and Toni Atkins want a "lifeline" rate. The federal grant/loan regulations are permissive in this regard, allowing adoption of a low-income rate with the proviso that the resultant revenue shortfall be made up within the customer class. 218 prohibits any such subsidized rate unless the shortfall is made up by the general fund and not by other ratepayers. If 218 applies, the Mayor can't have his "lifeline" rate; if it doesn't, he can. I'm prepared, based on past practice, to tell him he can't have it, but I expect all of you to back me up when I do. What's it gonna be?

We 218 noticed yesterday's rate hearing, consistent with past practice. I would expect that in the event that a discussion of the cost of service study results (which we're planning to have in the December/January timeframe) includes the recommended adoption of changes in the rate structure on that date, this event would also have to be noticed. On the other hand, if the presentation were only for purposes of information leading to council direction to return at a later date with rate structure changes for discussion and adoption (like last May's budget hearings), noticing wouldn't be necessary. Do you agree?

Finally, if we change course on 218 and proceed as though it doesn't apply, i. e., no noticing, "lifeline rate", etc., will this constitute a disclosure item in the OS for

next summer's planned sewer debt issuance which could constitute a "road map" for litigation? If so, is it also a disclosure item with respect to MWWD's outstanding obligations? What are the likely consequences of such a disclosure?

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MEMORANDUM OF LAW

DATE: July 31, 2001

TO: George Loveland, Senior Deputy City Manager

FROM: City Attorney

SUBJECT: The Application of Article XIIID to Water, Sewer, and Storm Water Fees

INTRODUCTION

On November 6, 1996, California voters approved Proposition 218, which amended the California Constitution by adding articles XIIIC and XIIID. Article XIIID, section 6 of the California Constitution imposed requirements for imposing new, or increasing existing, property-related fees and charges, and also imposed limitations on the use of the revenue collected by such means. After the adoption of Proposition 218, the City imposed increases of its water service fees [Water Fees] and its sewer service fees [Sewer Fees]. Due to the lack of authority interpreting the provisions of article XIIID, the City deemed it prudent to comply with the newly enacted provisions of article XIIID, section 6 for the imposition of the fee increases. The City now proposes to increase its storm sewer service fees [Storm Fees][1] and additional increases of the Water and Sewer Fees. Since the adoption of Proposition 218, there have been a number of opinions issued by public and private entities, and the courts, regarding what fees and charges are property-related fees and charges subject to the provisions of article XIIID, section 6. In light of these opinions, you have asked us to reexamine how the provisions of article XIIID, section 6

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[1] The term "storm sewer" is used throughout this memorandum to refer to the systems utilized to collect, treat, or discharge storm water. As discussed later in this memorandum, the term "storm sewer" is used by the California Regional Water Quality Control Board for the issuance of National Pollutant Discharge Elimination System permits to entities which own and operate systems which discharge urban runoff into United States' waters.

affect the City regarding the imposition of the proposed increases of its Water, Sewer, and Storm Fees.

QUESTIONS PRESENTED

1. Are the Water Fees property-related fees and charges subject to the provisions of article XIIID, section 6 of the California Constitution, and should the City comply with the provisions of article XIIID, section 6 for an increase of the Water Fees?

2. Are the Sewer Fees property-related fees and charges subject to the provisions of article XIIID, section 6, and should the City comply with the provisions of article XIIID, section 6 for an increase of the Sewer Fees?

3. Are the Storm Fees property-related fees and charges subject to the provisions of article XIIID, section 6, and should the City comply with the provisions of article XIIID, section 6 for an increase of the Storm Fees?

4. Assuming the Sewer and Storm Fees are subject to article XIIID, section 6, are there any alternatives available to the City respecting compliance with the provisions of article XIIID, section 6 for the increase of its Sewer and Storm Fees?

SHORT ANSWERS

1. The Water Fees are not property-related fees and charges subject to the provisions of article XIIID, section 6. The City does not need to comply with the provisions of article XIIID, section 6 to increase its Water Fees.

2. The Sewer Fees are not property-related Fees and charges subject to the provisions of article XIIID, section 6. However, because of the City's outstanding debt and future bond issuances, until there is a published court decision that can be relied upon as definitive authority that consumption-based sewer service fees are not subject to the provisions of article XIIID, section 6, the City should continue to comply with the noticing provisions of article XIIID, section 6(a) respecting any increase of the Sewer Fees.

3. The Storm Fees, as currently structured, are property-related fees and charges subject to the provisions of article XIIID, section 6. Because of time constraints associated with the City's NPDES Permit, the City should comply with the voting requirements of article XIIID, section 6(c) for any increase of its Storm Fees. In order to position itself to successfully argue that the Storm Fees are not property-related fees or charges subject to the provisions of article XIIID, section 6, the City must restructure its current Storm Fees. The fees should be restructured in such a way that the fees are based upon the amount of the storm sewer service provided to the ratepayer.

4. If the City does not want to follow the notice or voting procedures of article XIIID, sections 6 (a) or (c), the City should consider initiating separate declaratory relief or validation actions to have a court definitively determine whether its Sewer Fees and Storm Fees (as revised) are subject to the provisions of article XIIID, section 6.

BACKGROUND

I. Requirements of Article XIIID of the California Constitution

Article XIIID, section 6(a)(1) imposes noticing procedures for imposing a new or increasing an existing property-related fee or charge. This section requires that the public agency proposing to impose a new or increase an existing property-related fee or charge provide written notice by mail to the record owner of each parcel upon which the fee or charge will be imposed. The notice must contain the following information: (1) the amount of the fee or charge; (2) the basis on which the fee or charge was calculated; (3) the reason for the fee or charge; and (4) the date, time, and location the public agency will conduct its public hearing on the proposed fee or charge. Cal. Const. art. XIIID, § 6(a)(1). Article XIIID, section 6(a)(2) further requires that the public hearing be held not less than forty-five days after the mailing of the notice. If at the conclusion of the public hearing the public agency receives written protests against the imposition of the proposed fee or charge from a majority of the affected property owners, the fee or charge may not be imposed. Cal. Const. art. XIIID, § 6(a)(2).

Article XIIID, section 6(b)(3) establishes in the California Constitution certain requirements that fees not exceed the reasonable cost of providing the service for which the fee or charge is imposed. Section 6(b)(3) provides that "[t]he amount of a fee or charge imposed upon a parcel or person as an incident of property ownership shall not exceed the proportional cost of the service attributable to the parcel."

Finally, article XIIID, section 6(c) of the California Constitution establishes new voter approval requirements for property-related fees and charges. In accordance with section 6(c), except for fees for water, sewer, and refuse collection services, any new property-related fee or charge or any increase of an existing property-related fee or charge must be submitted for voter approval. The vote must be submitted and approved by either (1) a majority vote of the property owners of the property subject to the fee or charge; or (2) a two-thirds vote of the electorate residing in the affected area. The election shall be conducted not less than forty-five days after the public hearing conducted in accordance with article XIIID, section 6(a)(2). Cal. Const. art. XIIID, § 6(c).

II. The City's Fee System

The City establishes Water Fees for its water customers based upon the costs incurred by the City to meet customer demand for water. San Diego Municipal Code [SDMC] §§ 67.0502, 67.0508. The City establishes Sewer Fees based upon the costs incurred by the City to transport and treat sewage and to operate and maintain its sewerage system. SDMC § 64.0404(a). The City also establishes separate water and sewer capacity charges for individuals who want to connect to the City's water and sewerage systems and whose connection will cause additional demand to be placed on either the water or sewerage systems. SDMC §§ 67.0513, 64.0410. The capacity charges are imposed as a means of recovering all or a portion of the cost of constructing facilities necessitated by such additional demand. Cal. Gov't Code § 66013(a)(3).

The current Water Fees established for single family residences are composed of two components: a base fee and a commodity charge. The base fee is determined by the size of a customer's meter (approximately $9.23 per month), and is charged to the customer regardless of whether the customer uses water. The base fee is based upon the assumption that the utility incurs certain costs in order to be in a position to serve the commodity to the customer upon demand. Those costs are incurred by the utility regardless of whether the customer uses the commodity or not. They include such costs as the general administrative costs of the utility for billing, payment processing, and account management. The size of the customer's connection provides a relative approximation of the amount of the water the customer conceivably could have delivered to his or her property. The base fee, however, does not fully recover all of the fixed costs associated with the water delivery system. The commodity charge is a three-tiered system for water consumption. The first tier is a rate of $1.27 per hundred cubic feet [HCF] for the first seven HCF consumed; the second tier is at a rate of $1.62 per HCF for the next eight to fourteen HCF consumed; and the third tier is at a rate of $1.79 per HCF over fourteen HCF consumed.

Water Fees established for customers who are classified as multi-family residential, commercial, and industrial users are also based on two components: a base fee and a commodity charge. Similar to residential users, the base fee depends on the size of the customer's water meter (from $9.63, up to $3,989.75 per month), and the commodity charge is set at a rate of $1.49 per HCF of water consumed. This type of rate structure assesses a higher charge per unit of water as the level of consumption increases. *See Brydon v. East Bay Mun. Utility Dist.*, 24 Cal. App. 4th 178, 184 (1994) (court found such a water rate structure to be valid).

In order for a person to be billed by the City for Water Fees, he or she must file an application with the Water Department to have water service initiated. The person initiating the service does not have to be the owner of the property to which the water is delivered. Regardless of what customer class the person falls in, the customer has a meter from which the City measures the amount of the water consumed. The meter is read by the Water Department to calculate the Water Fees to be charged to the customer based on his or her customer class. The meters may be permanent or temporary. SDMC §§ 67.0202, 67.0218. For example, a temporary meter may be

used at a construction site where water service is provided. After the construction is completed, the meter is removed from the construction site. A meter may be temporarily located in an agricultural field for irrigating crops. If the crops are rotated, the meter may be moved to another location or discontinued altogether. The agricultural water meter and the construction meter are read to determine the amount of the water consumed; the person for whom the water connections were made is then billed for that water. SDMC §§ 67.0503, 67.0509.

The Sewer Fees are comprised of two components, a base fee and a usage charge. The base fee is determined on the basis of whether the customer is a single family domestic customer ($8.77 per month) or whether he or she falls within any other customer class ($.51 per month). The base fee is based upon the assumption that there are certain fixed costs associated with the collection of the wastewater away from the customer's property. Those costs are incurred by the utility in order to serve the customer, regardless of whether the customer uses the service or not. As with the water base fee, they include such costs as general administrative costs of the utility for billing, payment processing, and account management. The base fee, however, does not fully recover all of the fixed costs incurred by the utility in providing the collection system necessary to serve the customer.

The usage charge is based on the characteristics of the sewage (volume of sewage, or flow, and suspended solids, or strength) discharged by each particular sewer user. Inasmuch as sewage discharge is not metered, water sales are used to approximate each customer's sewage flow. Water consumption, particularly during the winter months when external uses of water for irrigation and other purposes are minimized, provides a rough approximation of the volume of wastewater that flows from a property into the sewerage system.[2] Suspended solids are based upon the classification of the user, determined by site inspections and/or analyses as required or requested.

Single-family residential customers are billed based on their winter months water usage (approximately December through March). The average winter months water usage becomes applicable on July 1 of each year, based upon the individual customer's average water consumption during the previous winter months. Once the winter months water usage is applicable, the customer's monthly sewer service charge is fixed until the following July 1.

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[2]The courts have recognized that sewer service charges based upon water consumption, such as is used by the City, are valid. *Apartment Ass'n of Los Angeles County, Inc. v. City of Los Angeles*, 75 Cal. App. 3d 13, 17-18 (1977) (citing *In re City of Philadelphia*, 343 Pa. 47 (1941); *Town of Port Orchard v. Kitsap County*, 19 Wash. 2d 59 (1943); *Boynton v. City of Lakeport Mun. Sewer Dist.*, 28 Cal. App. 3d 91, 96 (1972).

Similar to Water Fees, in order for a person to be billed by the City for the Sewer Fees, he or she must file an application with the City to have his or her service initiated. SDMC § 64.0408. The person initiating the service does not have to be the owner of the property. *Id.*

Certificates of participation, have been issued to fund certain capital improvements for the repair, replacement, and expansion of the City's water system [Water Bonds].[3] Similarly, several series of revenue bonds have been issued for the City's sewer program to fund capital improvements for the repair, replacement, and expansion of the City's sewerage system [Sewer Bonds].[4] In order to both fund capital projects and make the debt service payments on the Water Bonds and the Sewer Bonds, the City raised the Water Fees and the Sewer Fees. Some of these rate increases have occurred subsequent to the adoption of Proposition 218. Although the City has never conceded that the City's Water Fees and Sewer Fees are property-related fees and charges pursuant to article XIIID, section 6 of the California Constitution, it elected to follow the noticing procedures of section 6(a) prior to approving any such rate increases. This decision was made, in part, to avoid any potential challenges to the Water Fees and Sewer Fees that were necessary to make debt service payments on the Water and Sewer Bonds.

In addition to the Water and Sewer Fees, the City also imposes Storm Fees. The Storm Fees are paid by the owner or occupant of any parcel that is connected to the City's sewerage system or water system. SDMC §§ 64.0404(b), 64.0408. The fees are used by the City to pay for a portion of the capital facilities, operations, and maintenance of the City's storm sewer system.

The City, the County of San Diego, the incorporated cities of San Diego County, and the San Diego Unified Port District currently are renewing their National Pollutant Discharge Elimination System permit (Calif. Regional Water Quality Control Board, San Diego Region, Order No. 20001-01, NPDES No. CAS0108758) [NPDES Permit] for their storm sewer

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[3]In 1998, the San Diego Facilities and Equipment Leasing Corporation [Corporation] issued the Water Bonds and is using the proceeds of the issuance to construct water system improvements. Pursuant to a Master Installment Purchase Agreement between the City and the Corporation, the City has agreed to make installment payments to purchase the project components from the Corporation. The installment payments are paid from net water system revenues and are designed to be sufficient to pay the debt service on the certificates. From a financial standpoint, an installment sale agreement payable from enterprise revenues is the functional equivalent of a revenue bond.

[4]In 1993, 1995, 1997, and 1999, the Public Facilities Financing Authority of the City of San Diego [PFFA] issued Sewer Revenue Bonds to fund capital improvements for the City's sewerage system. Pursuant to a Master Installment Purchase Agreement between the City and the PFFA, the City agreed to make installment payments to purchase components of the project funded by the proceeds of the bonds. The installment payments are paid from the sewer revenues and are designed to be sufficient to pay debt service on the bonds.

systems.[5] Each of the agencies [together the Co-permittees] owns or operates a storm sewer system through which it discharges urban runoff into the waters of the United States. The California Regional Water Quality Control Board [Regional Board] has made findings regarding the storm sewer systems of the Co-permittees and, through the proposed NPDES Permit, has imposed conditions on the Co-permittees for the operation and maintenance of their storm sewer systems. For the City, these conditions will require significant expenditures for capital improvements, operations, and maintenance. In order to fund these expenditures, the City has determined that the Storm Fees must be increased or some other revenue generating mechanism must be established. An influx of revenue for the storm sewer program will be needed as soon as February 2002, in order to meet some of the initial requirements set forth in the NPDES Permit.

The Storm Fees are based on a flat rate of ninety-five cents per month for single-family residential water and sewer customers, and approximately six and one-half cents per HCF of water used by industrial, commercial, and multi-family water and sewer customers. The Storm Fees appear on the water and sewer bill as a separate line item. The Storm Fees are charged when a person applies for the initiation of his or her water or sewer service. SDMC § 64.0408.

With this general background regarding the Water, Sewer, and Storm Fees, an analysis of the application of article XIII D follows. This memorandum first reviews the amendments to the California Constitution affecting property-related fees and charges and analyzes the approaches developed by the League of California Cities, the Howard Jarvis Taxpayers Association, the California Attorney General, and the courts in determining whether certain fees and charges are property-related fees and charges subject to article XIIID, section 6. In light of these analyses, the memorandum next discusses whether the Water, Sewer, and Storm Fees are property-related fees and charges and considers the risks associated with not complying with the provisions of article XIIID, section 6 for any increase of the Water, Sewer, and Storm Fees. Finally, the memorandum makes recommendations on how to proceed in raising future Water, Sewer, and Storm Fees.

ANALYSIS

I. What are property-related fees and charges pursuant to article XIIID, section 6?

"Fee" or "charge" is defined in article XIIID, section 2(e) as "any levy other than an ad valorem tax, a special tax, or an assessment, imposed by an agency upon a parcel or upon a person as an incident of property ownership, including a user fee or charge for a property related service." "Property related service" is defined in that section as "a public service having a direct relationship to property ownership." Cal. Const. art. XIIID, § 2(h). Specifically exempted from

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[5] A separate National Pollutant Discharge Elimination System permit is issued to owners and operators of sewerage systems for the collection, treatment, and discharge of wastewater.

the provisions of article XIIID are fees or charges imposed as a condition of property development. Cal. Const. art. XIIID, § 1(b).

The language of Proposition 218 is ambiguous and open to multiple interpretations. Since its adoption, a number of public and private entities have struggled with interpreting whether the newly enacted provisions of the California Constitution affect water, sewer, and storm sewer fees and charges. The League of California Cities, the office of the California Attorney General, the Howard Jarvis Taxpayers Association, and the California courts have all weighed in on this topic and have provided varying interpretations on what fees and charges are subject to the provisions of article XIIID, section 6. The interpretations given by these entities are instructive in determining whether the City's Water, Sewer, and Storm Fees are subject to the provisions of article XIIID, section 6.

A. Analysis by the League of California Cities

The League of California Cities has conducted several seminars and prepared an implementation guide [Implementation Guide] analyzing the constitutional provisions. The seminars and the Implementation Guide include analyses of the impact of article XIIID, section 6 on water, sewer, and storm sewer fees and charges. The Implementation Guide provides a balanced review of the two conflicting positions that have been embraced on whether water, sewer, and storm sewer fees and charges are property-related fees and charges. Additionally, it makes certain recommendations to public agencies charged with implementing the constitutional provisions.

The League of California Cities has been actively involved in submitting amicus briefs in the cases that have gone to the courts of appeal and the California Supreme court on article XIIID challenges. The majority of those cases have been successful in upholding the position articulated by the public agency whose fee or charge has been challenged. A review of the Implementation Guide is therefore useful in understanding the positions that are most often articulated on article XIIID.

1. Commodity Approach Proponents

The first position is referred to as the "commodity approach." Proponents of the commodity approach begin with the definition of "incident," which is defined in Black's Law Dictionary as:

> anything which inseparably belongs to, or is connected with, or inherent in, another thing . . . . Also, less strictly, it denotes

> anything which is usually connected with another, or connected for some purposes, though not inseparably.

Black's Law Dictionary 762 (6th ed. 1990).

Drawing upon this definition, proponents of this approach conclude that the phrase "fees imposed as an incident of property ownership" would apply only to fees inherently paid because a person owns property. The proponents look to the ballot arguments and campaign materials produced by the drafters of Proposition 218 to support this interpretation. They argue that the intent of Proposition 218 was to stop local agencies from using fees to avoid rules regarding the imposition of taxes and assessments, which are clearly imposed as an incident of property ownership.

The commodity approach proponents also cite the noticing procedures of article XIIID as an example of how fees that are based on the quantity of service provided are not property-related fees and charges. As an example, they note that article XIIID, section 6(a)(1) requires that the notice which must be mailed to each affected property owner, for the imposition of a new or for the increase of an existing property-related fee or charge, state the amount of the fee or charge proposed to be imposed. This implies, they conclude, that the amount of the fee must be capable of being calculated for each affected property prior to its imposition. However, it is impossible to perform such a calculation where the property owner's conduct determines whether the fee will be charged in the first place and how much the fee will be. In the context of water service, for example, where a person initiates the service and the amount of the fee charged depends on the amount of the water consumed, the agency proposing the fee cannot determine in advance the fee or charge the person will pay for the service.

Another relevant factor in the commodity approach analysis is the reference in article XIIID, section 2(e) to "user fees." Because this section does not provide a definition of "user fees," interpreting the term "user fees" to refer to all revenue devices that have been traditionally characterized as "user fees" extends Proposition 218's reach beyond the legislative purpose intended by its drafters.

Instead, the commodity approach proponents argue that the term "user fees" does not necessarily include fees imposed on a person who voluntarily has initiated a service such as water. The courts, rather, have sometimes interpreted the term "user fees" to mean fees imposed on a person because the person benefits from a government service that is provided without the property owner's consent. *See, e.g., U.S. v. Sperry Corp.*, 493 U.S. 52 (1989). The commodity approach proponents conclude that principles of statutory construction require that voters are presumed to understand the meaning of terms used in ballot measures. Thus, they conclude that voters are presumed to understand "user fees" to mean fees imposed for services that are not voluntarily initiated. In the context of water, sewer, and storm sewer services this would mean fees and charges that are imposed as an incident of property ownership, rather than fees imposed

because a person has requested and actually uses such water, sewer, or storm sewer services at a particular location.

Finally, the commodity approach proponents argue that the term "user fees" in article XIIID is modified by the phrase "for a property related service." Fees for a "property related service" are defined as services that "have a direct relationship to property ownership." Cal. Const. art. XIIID, § 2(h). The use of this qualifying phrase, they conclude, demonstrates that the drafters of Proposition 218 intended to regulate fees for services that benefit property owners because of their status as property owners. Such fees are clearly distinguishable from fees or charges for services that are provided as a result of a request for service or use of a service, and that provide a benefit to the user of the service.

2. Delivery Approach Proponents

The second approach is referred to as the "delivery approach." Delivery approach proponents point to the specific language of article XIIID, section 2(e) which defines "fees" to include "user fees or fees for a property related service"; and article XIIID, section 2(h) which defines "property related service" to mean "a public service having a direct relationship to property ownership." They argue that water fees are charged to provide a public service to property, and therefore are property related.

Delivery approach proponents further point to various California court decisions that have interpreted "user fees" to generally mean a fee that is paid for service received. *See, e.g., San Marcos Water Dist. v San Marcos Unified School Dist.*, 42 Cal. 3d 154, 164 (1986). Referring to the decision in the *San Marcos* case, these proponents conclude that if the service is provided to a property at the request of the property owner then the user fee paid for the service is property related.

Another argument of the delivery approach proponents concerns the provisions of article XIIID, section 3(b), which specifically exclude fees for electrical and gas services from the definition of "fee" imposed as "an incident of property ownership." The explicit exemption of fees for these services suggests that fees for other services, such as water, sewer, and storm services, not specifically identified were not intended to be exempted and therefore are included in the definition of "fees."

Proponents of the delivery approach also take note of the provisions of article XIIID, section 6(c). These provisions specifically exempt water, sewer, and refuse collection fees and charges from the requirement that any increase of an existing or imposition of a new fee or charge be subject to approval by a majority vote of the affected property owners. The proponents argue these fees are usually charged as a result of an election by the property owner to have the particular service provided. The term "incident to property ownership" should be interpreted broadly to include fees that are charged as an incident of electing to use a property-related

service. The availability of such services is essential to the use of one's land. Hence, they conclude, the services are incident to property ownership.

Finally, delivery approach proponents note that article XIIID, section 5 provides that the act should be construed liberally to effectuate its purposes of limiting local government revenue and enhancing taxpayer consent.[6] A liberal reading of article XIIID, section 6 would generally result in a broader interpretation being given to what constitutes a "property related fee or charge." The delivery approach is the approach most often articulated by the Howard Jarvis Taxpayers Association in its challenges to fees and charges imposed by public agencies. Inasmuch as the Howard Jarvis Taxpayers Association has been the plaintiff in the majority of the lawsuits challenging alleged property-related fees and charges imposed by public agencies, a discussion of the interpretations the association has given to the provisions of article XIIID is useful.

B. Analysis by the Howard Jarvis Taxpayers Association

In September 1996, the Howard Jarvis Taxpayers Association, the drafters of the initiative, prepared and distributed an annotated draft of Proposition 218 [Annotated Draft] in an attempt to explain the purpose and intent of the proposed constitutional amendments. The first relevant annotation to this discussion appears after article XIIID, section 1(b). This section provides that the provisions of article XIIID do not "affect existing laws relating to the imposition of fees or charges as a condition of property development." Cal. Const. art. XIIID, sect 1(b). The annotation to section 1(b) states that the drafters intended "to leave unaffected any existing law relating to developer fees. . . . [T]he focus of Proposition 218 is on those levies imposed simply by virtue of property ownership. Developer fees, in contrast, are imposed as an incident of the voluntary act of development." Annotated Draft 4 (1996). This distinction raises the issue of whether capacity charges are property-related fees or charges subject to the provisions of article XIIID.

In an annotation following article XIIID, section 6(a)(1) (the noticing procedures for the imposition of a new or the increase of an existing fee or charge), the drafters stated that "[t]his section is applicable to any fee imposed on a parcel basis or for fees which provide a property-related service. It does not affect fees that are not property related such as DMV fees, park fees, or administrative charges imposed by a local government." Annotated Draft 11 (1996). This

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[6]As discussed below, the courts have not accepted this line of argument. Rather they have looked to the plain meaning of the words contained in article XIIID, section 6 for their interpretation of what fees and charges constitute property-related fees and charges. *Apartment Ass'n of Los Angeles County, Inc. v. City of Los Angeles*, 24 Cal.4th 830, 844-45 (2001); *Howard Jarvis Taxpayers Ass'n v. City of San Diego*, 72 Cal. App. 4th 230, 237-38 (1999); *Howard Jarvis Taxpayers Ass'n v. City of Riverside*, 73 Cal. App. 4th 679, 687, 689 (1999).

language suggests that if the proposed fee is *not* imposed on a parcel basis or for a property-related service, then these provisions of article XIIID do not apply.

Article XIIID, section 6(b)(5) further refines the intent of the drafters regarding the imposition of new fees or the extension of existing fees. This section provides that "[r]eliance by an agency on any parcel map including, but not limited to, an assessor's parcel map, may be considered a significant factor in determining whether a fee or charge is imposed as an incident of property ownership for purposes of this Article." Cal. Const. art. XIIID, § 6(b)(5). The annotation following this provision states that the purpose of this section is to prohibit levies on parcels regardless of use of the services for which they were collected. Annotated Draft 13 (1996). Consequently, how an agency determines who will be charged a water, sewer, or storm sewer fee or charge may be significant in determining whether the provisions of article XIIID, section 6 are applicable. If an agency does not look to property ownership, but looks to the person who has initiated and is using the water, sewer, or storm sewer services, then an argument can be made that such fees are not imposed as an incident of property ownership and therefore are not property-related fees or charges.

Gas and electric service charges are explicitly excluded from the provisions of article XIIID governing property-related fees and charges. According to the drafters, these charges were excluded because they are generally metered and probably meet the "cost of service" requirements of the article XIIID, section 6. *Id.* at 6. This annotation arguably suggests that services that are metered (e.g., consumption-based water, sewer, and storm sewer fees) may also be exempt from the provisions of article XIIID, section 6.

A later annotation, however, seems to conflict with such an interpretation. The annotation to article XIIID, section 6(b), which governs the extension, imposition, or increase of a property-related fee or charge, provides that the "requirements of [section 6(b)] are applicable to all fees, including those that currently exist. In essence, these requirements mandate that fees not exceed the 'cost of service.'" *Id.* at 12. This annotation suggests that the drafters intended to include all fees, excepting only those that were explicitly identified, i.e., gas and electric service fees.

Article XIIID, section 6(c) provides that "[e]xcept for fees or charges for sewer, water, and refuse collection services, no property-related fee or charge shall be imposed or increased unless and until such fee or charge is submitted and approved" by a majority of the affected property owners. The annotation to this section states that "exemption for sewer, water and refuse collection is for voter approval *only*. Such fees must meet the five substantive requirements of [section 6(b), e.g., cost of service]. Exemption is based on the philosophy of attempting to reverse the end-runs around Proposition 13. Since water, sewer and refuse collection fees pre-date proposition 13, they were exempted from voter approval." *Id.* at 13 (emphasis added). An argument can be made that this annotation clarifies the drafters' intent that for all other provisions of section 6, including the noticing procedures for new or increased fees and charges contained in section 6(a), water, sewer, and storm sewer fees and charges are *not* exempt. Alternatively, it can

be argued that because the annotation only referenced the five requirements provided in section 6(b), the drafters only intended for these provisions to apply to water, sewer, and refuse collection fees.

From the foregoing, it is evident that the drafters' annotations may be useful in analyzing what fees and charges the Howard Jarvis Taxpayers Association consider to be property-related fees and charges subject to the provisions of article XIIID. As discussed below, however, the California Supreme Court and a number of California Courts of Appeal have rejected arguments based upon the Annotated Draft. Instead, the courts rely on the plain meaning of the words contained in the constitutional amendments. Rather than resorting to an interpretation provided by the drafters, the courts to look at the ordinary and common meaning of the words as they would have been understood by the voters.

C. Analysis by the California Attorney General

In addition to the analysis undertaken by the League of California Cities, and the Howard Jarvis Taxpayers Association, the California Attorney General's office has issued two opinions regarding which fees and charges are subject to article XIIID. In one opinion, the Attorney General concludes that a water service fee that is based on water consumption is not a property-related fee or charge subject to the provisions of article XIIID, section 6. 80 Op. Cal. Att'y Gen. 183 (1997). In the second opinion, the Attorney General concludes that a storm sewer system monthly user fee that is charged only to persons who are connected to the sewer system is a property-related fee or charge and is subject to article XIIID, section 6. 81 Op. Cal. Att'y Gen. 104 (1998).

1. Water Fees

The first Attorney General Opinion focuses on general principles of constitutional interpretation. Constitutional enactments must be given a practical, common sense construction; "the ballot summary and arguments and analysis presented to the electorate in connection with a particular measure may be helpful in determining the probable meaning of uncertain language." 80 Op. Cal. Att'y Gen. 183, 185 (1997) (quoting *Amador Valley Joint Union High Sch. Dist. v. State Bd. of Equalization*, 22 Cal. 3d 208, 244-246 (1978)). With these principles in mind, the opinion concludes that "[a] water charge that is based upon the ownership of land and calculated based upon the amount of land involved must be said to have a 'direct relationship to property ownership.'" As an example, the opinion cites California Water Code section 71630, which authorizes a municipal water district to impose a water standby assessment or availability charge which is calculated on the basis of acreage owned.

Water charges that are imposed whether or not the water customer is the owner of property are distinguishable from such property-related fees and charges, the opinion concludes. For example, California Water Code section 71610 permits water charges for water provided to

fill tanks for construction site operations. This section is cited as an example of such non-property related fees and charges. The opinion notes that these water charges clearly would not have a *direct* relationship to property ownership. 80 Op. Cal. Att'y Gen. 183, 185 (1997).

To support this position, the opinion looks to the voters' pamphlet supplied to the electorate regarding Proposition 218. The opinion concludes that "[w]hile the proponents indicate that 'taxes imposed on . . . water . . . bills' would come under the requirements of Proposition 218, such language suggests that the water charges themselves would not be subject to the proposition's requirements. [They] believe that each water fee or charge must be examined individually in light of the constitutional mandate." *Id.* at 186.

With the forgoing in mind, the opinion analyzes the particular water rate structure presented to the Attorney General for review. That water rate structure is tiered, based on the amount of water consumed by the customer. A rate mechanism that is consumption-based contrasts sharply with a rate mechanism that is established on a parcel or per acre basis. Thus, the opinion concludes, "fees for water that are based on metered amounts used are not 'imposed . . . as an incident of property ownership' and do not have 'a direct relationship to property ownership.' Consequently, such fees would not be governed by article XIIID of the California Constitution." *Id.* (footnote omitted).

2. Storm Fees

The Attorney General's opinion regarding storm sewer fees differs in its assessment. In this opinion, the Attorney General's office analyzes: (1) whether the monthly user fees charged for the operation and maintenance of a sanitation district's storm sewer system met the requirements of article XIIID; and (2) whether voter approval is required for any increase in the district's storm sewer fees.

In that matter, the sanitation district operates a sanitation sewer system and a storm sewer system. The two systems are operated separately. The sewer system connects to a water treatment plant and the storm sewer system transports water directly into San Francisco Bay. 81 Op. Cal. Att'y Gen. 104, 105 (1998). The customers of the district are charged separately for maintaining the two systems. Only persons who connect their property to the district's sewer system, however, are charged to maintain the storm sewer system. "Hence, owners of parcels used for storage facilities, parking lots, or other uses that do not require a sewer connection escape the fees." *Id.*

The opinion first concludes that the existing fees violate article XIIID, section 6(b) because the sewer customers pay for all storm sewer services even though properties not connected to the sewer also benefit from the storm sewer system. "Therefore, those who *are* charged the fees must pay more than the proportional cost of the services attributable to their own parcels." *Id.* at *106.*

The opinion goes on to address proposed increases of the storm sewer fees. The district proposed to revise its storm sewer fees. The proposed fee was "to be based upon the proportional cost of [storm sewer] services provided to each parcel, a schedule that will take into account the amount of impervious area of each developed parcel." *Id.*

The opinion concludes that the proposed revised fees are property-related fees because "the [storm sewer] system is intended to serve directly the property within the drainage area." *Id.* at *107* (citing Cal. Gov't Code § 53750(d) and (f)). The fees therefore must be approved in accordance with the voting procedures of article XIIID, section 6(c). According to the opinion, the proposed fees are neither "water" nor "sewer" fees within the meaning of article XIIID, section 6(c), and therefore are not exempt from the voting requirements for the imposition of new or the increase of existing fees. Article XIII, section 5(a) makes an exception to certain requirements for the levy of assessments for a number of listed services, including water, sewer, and flood control. The Attorney General reasoned that because flood control appears in article XIIID, section 5(a), but does not appear in section 6(c), the drafters must have purposefully intended to omit flood control from section 6(c). Thus, the opinion concludes, the omission of the term "flood control" from the section 6(c) voting exemption "evidences an intent to require prior voter approval of new or additional [storm sewer] system fees." *Id.* at 108.[7]

D. Court Decisions

1. *Apartment Association of Los Angeles County, Inc. v. City of Los Angeles*

In *Apartment Ass'n of Los Angeles, Inc. v. City of Los Angeles,* 24 Cal. 4th 830 (2001) [*Apartment Association*], the California Supreme court issued its first ruling in a case analyzing the provisions of article XIIID, section 6. In this case, Plaintiffs, landlords and their association, challenged a fee imposed upon them by the City of Los Angeles for inspections of residential apartment rentals. The City of Los Angeles imposed the inspection fee without complying with the noticing or voting requirements of article XIIID, section 6. The plaintiffs challenged the fee, claiming that it was a property-related fee or charge under the provisions of article XIIID, section 6. The fee, they alleged, is unenforceable because the city failed to submit the proposed fee to a vote of the affected property owners or the electorate in accordance with article XIIID, section 6(c).

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[7]As discussed below, the California Supreme Court has rejected a broad interpretation of article XIIID, and instead looks to the plain meaning of the words. *Apartment Ass'n of Los Angles County, Inc. v. City Los Angeles*, 24 Cal. 4th 830, 844-845 (2001).

The California Supreme Court adopted a very narrow construction of the term taxes and fees imposed as "incident of property ownership." The court found that the fee provisions of article XIIID apply only to fees imposed on property owners in their capacity as such:

> [T]he mere fact that a levy is regulatory (as this inspection fee clearly is) or touches on business activities (as it clearly does) is not enough, by itself, to remove it from article XIII D's scope. But the city is correct that article XIII D only restricts fees imposed directly on property owners in their capacity as such. The inspection fee is not imposed solely because a person owns property. Rather, it is imposed because the property is being rented. It ceases along with the business operation, whether or not ownership remains in the same hands. For that reason, the city must prevail.

Apartment Ass'n, 24 Cal. 4th at 838.

The court further analyzed the language of article XIIID, section 2(e), which defines "fee" or "charge" to mean "any levy other than an ad valorem tax, a special tax, or an assessment, imposed by an agency upon a parcel or upon a person as an incident of property ownership, including user fees or charges for a property related service." The court reasoned that:

> [A] levy may not be imposed on a property owner as such— i.e., in its capacity as property owner— unless it meets constitutional prerequisites. In this case, however, the fee is imposed on landlords not in their capacity as landowners, but in their capacity as business owners. The exaction at issue here is more in the nature of a fee for a business license than a charge against property. It is imposed only on those landowners who choose to engage in the residential rental business, and only while they are operating the business.
>
> [T]he constitutional provision does not refer to fees imposed *on* an incident of property ownership, but on a parcel or person *as* an incident of property ownership. [T]he distinction is crucial.
>
> Were the principal words *parcel* and *person* missing, and were *as* replaced with *on*, so that article XIII D restricted the city's ability to impose fees "on an incident of property ownership," plaintiff's argument might have merit.
>
> . . . .

> Accordingly, *if* article XIII D restricted the city's ability to impose a "tax, assessment, fee, or charge on an incident property ownership," plaintiff's argument might be persuasive. The business of renting apartments is an incident of owning them, an activity necessarily dependent on that ownership but not vice versa. One can own apartments without renting them, but no one can rent them without owning them.

Id. at 839-41 (footnotes and citations omitted).

From the foregoing, the court concluded that taxes, assessments, fees, and charges "are subject to the constitutional strictures when they burden landowners as *landowners.*" *Id.* at 842. The court applied a plain meaning to the provisions of article XIII D; it "applies only to exactions levied solely by virtue of property ownership." *Id.* For support of this strict construction, the court looked to the subordinate clauses in article XIIID, section 2(e) and (h). The court reasoned that "among the fees or charges covered by article XIII D, section 2, subdivision (e), is a 'user fee or charge for a property-related service.'" *Id.* at 843. Such a service is defined in article XIIID section 2(h) to mean "a public service having a direct relationship to property ownership." Thus, "the relationship between the city's inspection fee and property ownership is indirect— it is overlain by the requirement that the landowner be a landlord." *Id.*

The decision rejected the plaintiff's reliance on the liberal construction language of article XIIID, section 5, the position repeatedly relied upon by the Howard Jarvis Taxpayers Association and delivery approach proponents. The court cites for its authority the Fourth District Court of Appeal's decision in *Howard Jarvis Taxpayers Ass'n v. City of San Diego*, 72 Cal. App. 4th 230, 237-38 (1999), and concludes that the plain meaning of the language of article XIIID renders resort to a broad rule of construction unnecessary. *Apartment Ass'n*, 24 Cal. 4th at 844-45.

Although the decision in the *Apartment Association* case reviewed the application of article XIIID to what generally would be considered a regulatory fee, the decision has far reaching implications regarding fees for providing a service to an individual, such as water, sewer, and storm sewer services. If it can be shown that the fees and charges for water, sewer, and storm sewer services are *not* imposed on property owners in their capacity as such, such fees arguably are not subject to the provisions of article XIIID, section 6.

2. *Howard Jarvis Taxpayers Association v. City of Los Angeles*

In *Howard Jarvis Taxpayers Ass'n v. City of Los Angeles*, 85 Cal. App. 4th 79 (2000) [*Jarvis I*], the plaintiff, Howard Jarvis Taxpayers Association, challenged the city's water rates. Plaintiffs alleged that the fees and charges imposed for water services in the city of Los Angeles were special taxes or property-related user fees, imposed as an incident of property ownership, and therefore required voter approval. The association further alleged that ratepayers were

overcharged for water services and that the overcharges resulted in a surplus of revenues to the water fund. The surplus was illegally transferred to the city's general fund in violation of articles XIIIC and D.

The city argued that its water department had the power to set water rates and enjoy a reasonable rate of return. Moreover, the water fees were not property-related fees or a special tax within the meaning of article XIIID, rather they were charges for the sale of a commodity. *Id.* at 81.

The Court of Appeal agreed with the city and adopted the commodity approach often articulated by the League of California Cities. "Water rates established by the lawful rate-fixing body are presumed reasonable, fair, and lawful." *Id.* at 82 (citing *Hansen v. City of San Buenaventura*, 42 Cal. 3d 1172, 1180 (1986)). The burden of proof for establishing that rates are unreasonable rests on the plaintiff challenging the rates. *Id.* (citing *Elliott v. City of Pacific Grove*, 54 Cal. App. 3d 53, 60 (1975)). The plaintiff did not allege that the rates were unreasonable per se; rather it argued that the mere fact that there was a surplus of revenues demonstrated that the city was overcharging its ratepayers. The court dismissed this argument, noting that "a municipal utility is entitled to a reasonable rate of return and that utility rates need not be based purely on costs." *Id.* (citing *Hansen*, 42 Cal. 3d 1172, 1176, 1183 (1986)).

The court disagreed with the plaintiff that the charges imposed for water services were in reality special taxes imposed as an incident of property ownership.

> These usage charges are basically commodity charges which do not fall within the scope of Proposition 218. They do not constitute "fees" as defined in California Constitution, article XIII D, section 2, because they are not levies or assessments "incident of property ownership." (Subd. (e).) Nor are they fees for a "property-related service," defined in subdivision (h), as a "public service having a direct relationship to property ownership." As indicated in the ordinances setting water rates, the supply and delivery of water do not require that a person own or rent property where the water is delivered. The charges for water service are based primarily on the amount consumed, and are not incident to or directly related to property ownership.

Id. at 83 (footnote omitted).

On February 14, 2001, the California Supreme Court denied review of the *Jarvis I* decision. This decision has significant relevance to water, sewer, and storm sewer service fees and charges. Similar to the decision in *Apartment Association*, the appellate court reasoned that the language of article XIIID, section 2 defining "fee" and "property-related service" does not apply to fees that do not have a direct relationship to property ownership. Fees therefore, that are

charged to an individual based upon the amount of the individual's use of the service rather than his or her status as the owner of the property to which the service is provided, arguably are not property-related fees and charges within the meaning of article XIIID.

3. *Howard Jarvis Taxpayers Ass'n v. City of Salinas*

In *Howard Jarvis Taxpayers Ass'n v. City of Salinas*, Monteray County Superior Court case number M45873 (2001) [*Jarvis II*], the plaintiff, Howard Jarvis Taxpayers Association, challenged the City of Salinas' adoption of storm sewer fees. The fees are collected on the property tax roll and were adopted without a landowner or registered voter election. Instead, Salinas adopted the fees in compliance with the noticing provisions of article XIIID, section 6(a). Salinas asserted that the fees are exempt from the voter approval provisions of article XIIID, section 6(c) because they are water or sewer fees. Salinas prevailed in the trial court on a summary judgment motion. The plaintiff filed an appeal. Although the court of appeal has not rendered a decision in this matter, the arguments presented by Salinas and adopted by the trial court are worth examining to determine whether the City may wish to follow a similar course in the adoption of any proposed increase in its Storm Fees.

Salinas begins its argument with the premise that article XIIID, section 6(c) specifically exempts from the voter approval process fees for water, sewer, and refuse collection services. Salinas asserts that its storm sewer fees fall within the exemptions for both sewer and water services fees. Salinas also asserts that the fees are not imposed upon a person "as an incident of property ownership;" rather they are user fees which are directly related to the burden placed on the storm sewer system. Because property owners may avoid the fees by arranging for their own on-site storm water management facilities, the fees are not an "incident of property ownership" subject to article XIIID, section 6.

For support for its position, Salinas noted that it operates a sanitary sewer, a storm sewer, and an industrial waste sewer system. Article XIIID does not define the term "sewer." Using standard principles of statutory construction, Salinas looked to dictionary definitions of the word "sewer" to demonstrate that the common usage definitions of the word include storm water within the meaning of sewer. Some of the dictionary definitions for sewer used in the city's trial brief include:

> "1: a ditch or surface drain; 2: an artificial usu. subterranean conduit to carry off water and waste matter (as surface water from rainfall, household waste from sinks or baths, or waste water from industrial works)." Webster's Third New International Dictionary of the Language, Unabridged 2081 (1976).

> . . . "An artificial, usually underground conduit for carrying off sewage or rainwater." American Heritage Dictionary of the English Language 1187 (1969).
>
> . . . "1. An artificial water course for draining marshy land and carrying off surface water into a river or the sea. 2. An artificial channel or conduit, now usually covered and underground, for carrying off and discharging waste water and the refuse from houses and towns." 2 Compact Edition of the Oxford English Dictionary 2756 (1971).

Defendant's Trial Brief, *Howard Jarvis Taxpayers Ass'n v. City of Salinas*, Monterey County Superior Court No. M45873, 10-11 (Aug. 23, 2000).

Salinas also relied on the California Public Utilities Code definition of "sewer system," which includes "any and all drains, conduits and outlets for surface or storm waters, and any and all other works, property or structures necessary or convenient for the collection or disposal of sewage, industrial waste, or surface or storm waters." *Id.* at 11 citing Cal. Pub. Util. Code § 230.5. Finally, Salinas relied on its own city code, which provides that "'Storm drain' means a sewer which carries storm and surface waters and drainage." *Id.*, citing Salinas City Code § 36-2(31).

In addition to asserting that its storm sewer fees are exempt as sewer fees, Salinas also claimed that they are exempt as water fees. The term "water" is defined in California Government Code section 53750(m) (a provision of the implementing legislation for article XIIID adopted by the California legislature). This provision provides that "[w]ater means any system of public improvements intended to provide for the production, storage, supply, treatment, or distribution of water." Thus, Salinas maintains that if the city's system of pipes, drains, ponds and treatment facilities is not considered a "sewer" system, then alternatively it should be considered a "water" system. Salinas posits that the storm water runoff is discharged into ponds, and basins, and then it percolates into underground aquifers. The recharging of these aquifers is an important source of water to the city's water supply. Salinas therefore concludes that the storm water is water and its storm drainage fees are exempt from the election requirements of article XIID, section 6(c).

The final argument presented by Salinas is that the storm sewer fees are not property-related fees within the meaning of article XIIID, section 6. The fees are not imposed on property owners who do not use the storm sewer facilities. Undeveloped property or property which has its own on-site storm water management system is either not charged the storm sewer fee or is charged a reduced fee. The fees are commensurate with the cost of providing the service to individual properties and are not imposed as an incident of property ownership or as a user fee for a property-related service.

The trial court ruled in favor of Salinas and adopted the city's position that the storm sewer fees are fees related to sewer and water services and therefore are exempt from the voter approval requirements of article XIIID, section 6(c). The court further found that the fees are not property-related fees and charges inasmuch as the fees have a direct relationship to usage of the storm sewer system and are incurred only if a property owner uses the system.

With the foregoing analyses by the League of California Cities, the Howard Jarvis Taxpayers Association, the California Attorney General, and the California courts in mind, a discussion of whether article XIIID, section 6 applies to the Water, Sewer, and Storm Fees and water and sewer capacity charges follows.

II. Are the City's Water, Sewer, and Storm Fees subject to the provisions of article XIIID, section 6?

A. City's Water and Sewer Fees, and Capacity Charges

1. Water and Sewer Fees

The commodity approach has been adopted by the California Attorney General's office and at least one court of appeal in their analysis of water fees that are consumption-based. Although these opinions analyze water fees, they are equally applicable to a sewer fee that is consumption based. The California Supreme Court's decision in *Apartment Association* also provides support for asserting that fees that are not imposed by virtue of property ownership are not subject to the provisions of article XIIID, section 6. While this opinion does not analyze either a water or a sewer fee it also has application in the analysis of whether the Water and Sewer Fees are subject to article XIIID, section 6.

The Attorney General's opinion concludes that a structure that is consumption based contrasts sharply with a rate mechanism that is established on a parcel or per acre basis. The opinion concludes that consumption-based water fees are not property-based fees and charges subject to the provisions of article XIIID, section 6. In *Jarvis I* the court concluded that water fees which are primarily based on the amount of the commodity consumed are not incident to or directly related to property ownership. Such fees, the court reasoned, are therefore not property-related fees and charges subject to the provisions of article XIIID, section 6. The California Supreme Court's decision in *Apartment Association* similarly provides support for the assertion that if a fee is not imposed upon a person in his or her capacity as a property owner, such fees are not incident to property ownership and therefore are not subject to the provisions of article XIIID, section 6.

Given the decisions in *Jarvis I* and *Apartment Association*, as well as the Attorney General's opinion on water charges, it is clear that the Water and Sewer Fees are not property-related fees and charges within the meaning of article XIIID, section 6. First, the fees are not

imposed as an incident of property ownership. Ownership of property does not determine who will be charged the Water and Sewer Fees. Additionally, the Water Department and the Metropolitan Wastewater Department do not rely on a parcel map to determine whether a fee or charge should be imposed. Rather, the departments require that a customer open an account and initiate service. As was the case in the water district analyzed by the California Attorney General, *Jarvis I*, and *Apartment Association*, the Water and Sewer Fees are not imposed solely because a person owns property. Paraphrasing the California Supreme Court, the fees cease along with cessation of the service. *Apartment Ass'n*, 24 Cal. 4th at 834.

The Water and Sewer Fees are both based on the amount of the service consumed by water and sewer customers. As discussed above, a water customer is billed based on the amount of water he or she consumes at the property for which he or she has initiated service. A meter is connected to the property to measure this amount. Similarly, a sewer customer is billed based on his or her winter months water usage. The amount of water consumed during this period provides the best approximation of the amount of wastewater the sewer customer discharges into the sewerage system. This water usage is measured through the same water meter. Moreover, the individual receiving the water or sewer service does not have to be the owner of the property.

Second, the noticing provisions of article XIIID, section 6(a)(1) assume that property-related fees may be readily calculated on a per parcel basis. These provisions state that the amount of the fee or charge proposed to be imposed shall be calculated.[8] Among other things, the agency proposing to impose the new or increased fee must provide notice to the record owner of each affected property of (1) the amount of the fee or charge proposed to be imposed, and (2) the basis on which the fee or charge was calculated. Cal. Const. art. XIIID, § 6(a)(1). The Water and Sewer Fees are established on a consumption-based rate structure. The amount charged to an individual customer is not capable of calculation until that customer has used the services.

Finally, with the decisions in *Apartment Association* and *Jarvis I*, the courts have clearly indicated that they apply a plain meaning to the language in article XIIID. Article XIIID "applies only to exactions levied by virtue of property ownership." *Apartment Ass'n*, 24 Cal. 4th 830, 842. Fees that are charged to an individual based upon the amount of the individual's use of the service rather than his or her status as the owner of the property to which the service is provided, are not property-related fees and charges within the meaning of article XIIID, section 6. *Jarvis I*, 85 Cal. App. 4th at 83; 80 Op. Cal. Att'y Gen. 183, 186 (1997). The applicability of these decisions to the Water and Sewer Fees is evident. Both fees are calculated based on consumption of the services provided, rather than incident to property ownership.

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[8]The provisions of article XIIID do not explain how a public agency shall calculate fees, such as water fees and sewer fees, that are determined by the consumer's conduct.

2. Water and Sewer Capacity Charges

To date, there have not been any cases challenging the applicability of article XIIID to capacity charges. The Annotated Draft, however, provides some insight into what issues may be raised in the event that a challenge is ever brought against the City respecting an increase in its capacity charges. According to the Annotated Draft, the drafters of Proposition 218 intended "to leave unaffected any existing law relating to developer fees. . . ." Annotated Draft 4 (1996). Because developer fees are imposed as an incident of the voluntary act of development, the drafters were not concerned with the imposition of developer fees and specifically exempted them from the mandates of article XIIID. *Id.*

Developer fees have been defined by the courts to mean "an exaction imposed as a precondition for the privilege of developing land, commonly exacted in order to lessen the adverse impact of increased population generated by the development." *Carlsbad Muni. Water Dist. v. QLC Corp.*, 2 Cal. App. 4th 479, 485 (1992). In *Carlsbad*, the court concluded that capacity charges imposed by the Carlsbad Municipal Water District are development fees. In relation to the City's water fees and charges, the article XIIID, section 1(b) exemption for developer fees would appear to include capacity charges. Like those imposed by the Carlsbad Municipal Water District, the City's water and sewer capacity charges are paid when a person requests a new water or sewer connection or in any way causes an increase in water usage. Payment of the capacity charge is due when building permit fees or water connection fees are paid, and therefore is a precondition to development. SDMC §§ 67.0513, 64.0410.

An argument can be made, however, that the City's capacity charges are property-related fees and charges subject to the provisions of article XIIID. In analyzing the nature of capacity charges, some courts have determined that a capacity charge is "in effect a special assessment under a different name." *San Marcos Water Dist. v. San Marcos Unified School Dist.*, 42 Cal. 3d 154, 161 (1986); *accord Regents of Univ. of Calif. v. City of Los Angeles*, 100 Cal. App. 3d 547, 549-50 (1979); *County of Riverside v. Idyllwild County Water Dist.*, 84 Cal. App. 3d 655 (1978). "Assessment" is defined in article XIIID, section 2(b) as "any levy or charge upon property by an agency for special benefit conferred upon the real property." Cal. Const. art. XIIID, § 2(b). Thus, although a capacity charge *is not* an assessment, it arguably is in the nature of an assessment and therefore is "property related." The more persuasive argument, however, is that capacity charges are not property-related fees and charges. They are not paid as an incident of property ownership but as an incident of property development. Hence, they come under the "developer fee" exemption of article XIIID, section 1(b).

B. Storm Fees

Assuming the Attorney General's analysis on the issue of storm sewer fees is correct, storm sewer service fees that are not directly related to use of the storm sewer system, are property related and subject to the provisions of article XIIID, section 6(c). Such is the case with

the Storm Fees. The current rate structure for the Storm Fees is a flat rate, imposed on any person who connects to the water or sewerage system. The fees do not take into account the amount of storm water runoff that a property may generate based on its land use or any other factor which would be relevant to determining whether or how much storm sewer service is being provided to a property.

The applicability of the *Jarvis I* decision to the Storm Fees is even more tenuous. The Storm Fees are billed based on a flat rate for single-family residential water and sewer customers and on water consumption for industrial, commercial, and multi-family water and sewer customers. As previously noted, there is no correlation between the amount charged to the customer and the amount of the service provided to the customer as is suggested in *Jarvis I*. There is a potential argument, however, that the Storm Fees are not property-related fees in that an individual is billed for the service only if he or she initiates water or sewer service to a property. That individual does not have to be the owner of the property. Thus, the fee is not directly related to property ownership, rather it is related to the use of the City's storm sewer services.

This argument would be more persuasive if the Storm Fees had a more direct relationship to use of the storm sewer system by the ratepayer than the current rate structure for storm sewer services indicates. For example, if the rate structure was based on an examination of particular land uses and their contribution of storm water to the storm sewer system (i.e., the impermeability of the land), then such storm fees would be more directly related to the amount of the services "consumed" by the ratepayer than to his or her ownership of the property. Properties that do not accelerate storm water runoff (e.g., unimproved properties) under such a rate structure would be charged a lower rate inasmuch as the property owner chooses to "consume" a lesser amount of the City's storm sewer services. This was the rate structure adopted by the city of Salinas and challenged in *Jarvis II*.

In light of the California Supreme Court's decision in *Apartment Association*, the arguments presented by the city of Salinas in *Jarvis II* may have some merit. The California Supreme Court has stated that it will apply a plain meaning to the interpretation of article XIIID, section 6. *Apartment Ass'n*, 24 Cal. 4th at 844-45. The dictionary definitions identified in *Jarvis II* provide a plain meaning to the term "sewer" which would include storm water. The Salinas City Code also reiterates that the city considers its storm sewer system to be a sewer. With respect to our own Municipal Code, however, the definition provided to the term "storm water" does not provide as clear an association between what the City considers to be its sewer system and its storm sewer system.

The City's municipal code defines "storm water" to mean "surface runoff and drainage associated with storm events and snow melt which is free of [p]ollutants to the maximum extent possible." SDMC § 43.0302. There are instances in which storm water goes into the City's sewer conveyance system to a treatment facility (e.g., a low flow diversion facility), or goes to some

other on-site treatment facility through a conveyance system (e.g., continuous debris separators, detention ponds, grass swales, catch basin inserts). In such instances, the City may argue that its storm sewer system is a sewer system within the plain meaning of article XIIID, section 6 and any fees charged for such storm sewer services are either exempt from the provisions of article XIIID, section 6 or only subject to the noticing procedures of section 6(a) for any increase thereof.

The City may also look to the NPDES Permit for support that its storm sewer system is in effect a sewer system as that term is understood for the purposes of article XIIID, section 6. The NPDES Permit sets forth the waste discharge requirements for discharges of urban runoff from the City's "storm sewer system." The NPDES Permit specifically uses the term "storm sewer system" in the permit. It further provides that urban runoff is a "waste," as that term is defined in the California Water Code. NPDES Permit, 1. California Water Code section 13050 defines "waste" to mean "sewage and all other waste substances, liquid, solid, gaseous, or radioactive, associated with human habitation, or of human or animal origin, or from producing, manufacturing, or processing operation, including waste placed within containers of whatever nature prior to, and for purposes of, disposal." This definition demonstrates a clear association between sewage and storm water. Reading the Municipal Code, the NPDES Permit, and the Water Code together, and applying a plain meaning to article XIIID, the City's storm sewer system arguably is a sewer system within the meaning of article XIIID, section 6. The Storm Fees under such an analysis therefore are fees or charges for sewer services.

Even assuming that Salinas' analysis is correct, and storm sewer fees are equivalent to sewer fees, the City will need to demonstrate that the Storm Fees are not property-related fees and charges subject to the provisions of article XIIID, section 6(a). The lack of correlation between the rate structure for the Storm Fees and the amount of the services consumed by the ratepayers is problematic for framing such an argument. Without this correlation it is difficult to argue that the Storm Fees are *not* directly related to property ownership, but are related to use of the storm sewer system. In order to fashion an argument that the Storm Fees are not property-related fees and charges within the meaning of article XIIID, section 6, the current rate structure would have to be revised. Additionally, it would be advisable to amend the Municipal Code provisions governing the storm sewer and sewerage systems to more clearly demonstrate that the City's "storm sewer system" is a sewer system as that term is given its plain meaning in article XIIID, section 6.

Notwithstanding the foregoing conclusions respecting the application of article XIIID to the Water, Sewer, and Storm Fees, the City must make certain policy decisions regarding whether it will comply with the hearing and notice or voting requirements of article XIIID for any future rate increases. The following section discusses the implications of such policy decisions.

III. Should the City comply with the notice and hearing or voting requirements of article XIIID, section 6?

As previously discussed, article XIIID, section 6(a)(1) imposed noticing requirements for imposing a new, or increasing an existing, property-related fee or charge. This section requires that the public agency proposing to impose a new or to increase an existing property-related fee or charge provide written notice by mail to the record owner of each parcel upon which the fee or charge will be imposed notifying him or her of: (1) the amount of the fee or charge; (2) the basis on which the fee or charge was calculated; (3) the reason for the fee or charge; and, (4) the date, time, and location the public agency will conduct its public hearing on the proposed fee or charge. Cal. Const. art. XIIID, § 6(a)(1). Article XIIID, section 6(a)(2) further requires that the public hearing be held not less than forty-five days after the mailing of the notice. If at the conclusion of the hearing the public agency receives written protests against the imposition of the proposed fee or charge from a majority of the property owners, the fee or charge may not be imposed. Cal. Const. art. XIIID, § 6(a)(2).

Article XIIID, section 6(c) requires that except for fees or charges for water, sewer, and refuse collection services, a public agency proposing to impose a new or increase an existing property-related fee or charge shall submit the fee proposal to a vote of the affected property owners or the electorate residing in the affected area. If the vote is by the property owners, then a majority of the property owners must approve the new fee or increase of the existing fee. If the vote is of the electorate, then a two-thirds vote is required for approval. Cal. Const. art. XIIID, § 6(c).

A. City Water and Sewer Rate Increases

After the adoption of Proposition 218, the City elected to follow the noticing requirements of article XIIID, section 6(a) when it proposed a rate increase on August 12, 1997, for its Water Fees, and on January 19, 1999, for its Sewer Fees. Although the City did not concede at that time that the Water and Sewer Fees are property-related fees or charges and therefore subject to the noticing provisions of Article XIIID, section 6(a), the lack of any enabling legislation or case law interpreting these provisions caused the City to err on the side of caution in bringing its rate increases forward to the City Council for approval.

In particular, this decision was made because of the Water Department's plans to issue its first series of Water Bonds for its capital improvement program in the spring of 1998, and the Metropolitan Wastewater Department's outstanding and future bond issuances. Certain risks were identified if the City did not comply with the noticing provisions in bringing its proposed rate increases forward. These risks were as follows: First, the City could be sued by the Howard Jarvis Taxpayers Association or a water or sewer ratepayer. Any lawsuit could result in protracted litigation, thereby delaying the imposition of the Water and Sewer Fees and construction of the water and sewer capital improvement programs. The need for the revenue from the rate increases

for the capital program and bond payments caused the City to avoid these risks. Additionally, if a legal challenge had been filed, the City would have been required to disclose the litigation in the offering documents for the Water and Sewer Bonds. Such disclosure could have had a negative impact on the sale of the securities. Second, the City also would have been required to disclose the mere fact that the City did not follow the noticing procedures of article XIIID, section 6. That disclosure also could have had a negative impact on the sale of the bonds. Finally, the City is under a compliance order by the California Department of Health Services to construct certain capital improvements for its water system and a final order by a federal district court to construct certain capital improvements for its sewerage system. Any delay in the issuance of the Water Bonds and Sewer Bonds could have had significant ramifications, both financial and legal, ono the two programs.

In *Jarvis I*, a court of appeal definitively found that a water fee based upon consumption of the water commodity is not a property-related fee or charge and therefore is not subject to the provisions of article XIIID, section 6. The City's Water Fees fully comport with the water rate structure approved by the court of appeal in *Jarvis I*. The California Supreme Court has denied review of this decision and further rejected the plaintiff's request to depublish the opinion. It is very clear, therefore, that the Water Fees are not subject to the provisions or article XIIID, section 6. The City therefore does not need to comply with the hearing and notice provisions of article XIIID, section 6(a) for any future increases of its Water Fees.

At present, however, there are no published opinions by a California court finding that sewer fees and charges that are based on consumption of sewer services are not property-related fees and charges. The City therefore must decide if it will continue to follow the noticing procedures of article XIIID, section 6(a) for any future increases of its Sewer Fees. While the likelihood of any challenge succeeding is very small, there is a possibility that a court could find that sewer services are sufficiently different from water services such that the analysis in *Jarvis I* is not applicable. Water clearly is a commodity which you purchase from a purveyor of the product. Sewer fees are a charge for a service provided, the conveyance and treatment of waste water from property. Given the lack of a judicial determination on this issue, the risks previously identified with failing to comply with article XIIID, section 6(a) for any future increase of the Sewer Fees, however remote, remain the same.

B. Storm Fee Rate Increases

The City currently is operating its storm sewer system under the terms and conditions of the NPDES Permit. That permit has a number of terms and conditions which are time sensitive. Of primary concern is the requirement that the City have in place by February 2002 its storm sewer program in compliance with the NPDES Permit conditions. Additionally, it must have in place a fiscal analysis for the program demonstrating how the City will pay for the program. Failure to meet these deadlines could result in fines to the City by the Regional Board. The need

for revenue from the Storm Fees to fund these improvements and the ongoing operations and maintenance therefore is also time sensitive.

As with sewer fees, there are no published court decisions determining whether storm sewer fees are property-related fees and charges. The only published opinion is one by the California Attorney General, and that opinion found that storm sewer fees are subject to the voting provisions of article XIIID, section 6(c). The court of appeal in *Jarvis II* has not rendered an opinion, and it is not likely that there will be a decision until this fall at the earliest. Assuming that the appellate court decision is favorable, it is likely that the Howard Jarvis Taxpayers Association would appeal the decision. In the event of an appeal, the City could not rely upon the court of appeal decision. With the need for revenues for the storm sewer program by February 2002, waiting for a court decision on this issue may not be an option. In addition to the timing issues associated with obtaining a final decision in the *Jarvis I* case, it is more difficult to argue that storm sewer fees and charges are fees and charges for services consumed by a ratepayer. Given these parameters, and the deadlines associated with the City's NPDES Permit, the City will need to decide whether to raise the Storm Fees in compliance with the voting provisions of article XIIID, section 6(c).

IV. Are there any other alternatives available to the City regarding its Sewer and Storm Fees?

A. Sewer Fees

If the City does not want to follow the noticing procedures for future increases of the Sewer Fees, then it should take some form of legal action to resolve whether its Sewer Fees are in fact property-related fees subject to the provisions of article XIIID, section 6. To initiate such an action, the City should follow the noticing procedures of article XIIID, section 6(a) and file a declaratory relief action or validation action, asking a court to determine whether consumption-based sewer fees and charges are property-related fees and charges subject to the notice and hearing procedures of article XIIID, section 6(a). Although such action may resolve the matter for the City, there is some risk in asking for a court's determination of the matter. The court could find that the Sewer Fees are property-related fees and charges, or the City could have to litigate the matter in court for several years. Ultimately, however, the issue would be resolved.

B. Storm Fees

With regard to the Storm Fees, if the City does not proceed with a vote pursuant to article XIIID, section 6(c) for a fee increase, it should consider taking legal action to assert or clarify its position by initiating a declaratory relief action or a validation action. This would first require that the City take some form of action to raise its Storm Fees. One method to initiate such an action would be to comply with the noticing procedures of article XIIID, section 6(a) but assert (1) that the storm sewer services are sewer services as that term is understood in

article XIIID, section 6, and (2) that the storm sewer services are *not* property-related fees and charges. In the event that a court determines that the fees are sewer services, the City then has at least complied with the noticing provisions of article XIIID, section 6(a), thereby avoiding one additional challenge to the rates. The risk in this approach is that if a court determines that the Storm Fees are not sewer fees within the meaning of article XIIID, section 6, the City will have lost a significant amount of time in collecting the revenue necessary to comply with the mandates of the NPDES Permit.

The second method for initiating such an action goes one step farther. It also presumes (1) that storm sewer services are sewer services, and (2) that sewer services are not property-related fees and charges. However, the City would simply raise the Storm Fees without either sending a notice in compliance with article XIIID, section 6(a), or submitting the increase to a vote in compliance with article XIIID, section 6(c). This latter alternative is riskier because it is vulnerable to challenge as violative of both article XIIID, sections 6(a) and 6(c).

In either case, it would be advisable to change the current rate structure for the Storm Fees to more closely correlate the amount of the fee imposed to the amount of the services consumed by the ratepayer. Additionally, the Municipal Code sections governing the sewerage system and the storm sewer system should be amended to provide a stronger position for the City to argue that a plain reading of the term "sewer system" includes storm sewer system. Finally, the City should not collect any of the proposed increase in the Storm Fees until the matter is resolved in order to avoid the risk of future refunds should the City's validation or declaratory relief action fail.

In the event the City elects to go forward with a rate increase for its Storm Fees, and to initiate a declaratory relief or validation action to validate the rates as outlined above, the City will need to work cooperatively with the Regional Board to negotiate extensions for the implementation of the NPDES Permit requirements. Alternatively, the City will need to have other sources of revenue available on an interim basis to fund the capital improvement and operations and maintenance expenses necessitated by the NPDES Permit requirements.

CONCLUSION

Since the adoption of Proposition 218, public agencies tasked with the responsibility of providing water, sewer, and storm sewer services have struggled with interpreting whether the broad language of the newly enacted provisions of the California Constitution apply to their water, sewer, and storm sewer fees and charges. Opinions have been provided by the League of California Cities, the Howard Jarvis Taxpayers Association, the California Attorney General's office and the courts on the applicability of article XIIID, section 6 to water, sewer, and storm sewer services. These opinions are instructive in analyzing the Water, Sewer, and Storm Fees.

The Court of Appeal in *Jarvis I* determined that consumption-based water fees and charges are not property-related fees and charges within the purview of article XIIID, section 6. That decision, review of which was denied by the California Supreme Court, provides ample authority that the provisions of article XIIID, section 6(a) do not apply to the City with respect to any future increases of its Water Fees. Additionally, the decision of the California Supreme Court in *Apartment Association* provides further support for a plain reading of the language of article XIIID. The import of this decision is that it limits the application of the provisions of article XIIID to fees and charges that are imposed upon a property owner in his or her capacity as such. The City's Water Fees clearly are not imposed in such a manner.

The decisions in *Jarvis I* and *Apartment Association* can be interpreted to further conclude that the Sewer Fees are not property-related fees and charges subject to article XIIID, section 6. Until a court renders a decision on consumption based sewer fees, however, the City cannot definitively assert that its Sewer Fees do not have to comply with the noticing provisions and the cost of service provisions of article XIIID, section 6(a). If the City decides not to comply with these provisions, then it must disclose this decision in the offering documents for any future revenue bonds for its waste water capital improvement program. As discussed above, there are certain risks associated with such a decision.

Similarly, the City can assert that its storm sewer services are sewer services within the meaning of article XIIID, section 6. If they are sewer services, then arguably they also are not property-related fees or charges subject to the provisions of article XIIID, section 6. While one trial court has accepted the initial premise that storm sewer services are sewer services, that decision is on appeal.

As the City prepares to bring forward increases of its Sewer and Storm Fees, the City must determine whether it will (1) comply with the provisions of article XIIID, section 6; (2) initiate a validation or declaratory relief action to resolve the matter; or (3) wait until a court decision resolves whether sewer and storm sewer service fees that are based on the amount of the services consumed by the ratepayer are subject to the provisions, if any, of article XIIID, section 6. There is some risk to the City in pursuing a judicial resolution of this issue. In any instance, however, it would be advisable for the City to revise its current Storm Fee rate structure to demonstrate that the Storm Fees are based on the amount of the storm sewer service being provided to the ratepayer.

CASEY GWINN, City Attorney

By
Kelly J. Salt
Deputy City Attorney

KJS:pev
ML-2001-15

EXHIBIT 4

764113
Wastewater Hot 3-10-06

Email message text
Object type: [GW.MESSAGE.MAIL]
Item Source: [Received]
Message ID: [3CB5B47E.Demo-dom.Demo-PO.100.16E696E.1.168B.1]
From: [Kelly Salt]
To: []
Subject: [Fwd: Sewer 218 Closed Session Issue]
Creation date: [1/18/2002 4:42:52 PM]
In Folder: [Mailbox]
Attachment File name: [E:\Output\KKatz1\4223.1-GW.MESSAGE.MAIL]
Message: [
Cathy, Keri Katz asked me to contact you regrading the closed session item for Tuesday concerning Sewer Fees. The reason for our going to council in closed session is explained in more detail in the attached e-mail from Dennis Kahlie in Financing Services. I also left you a message to call me on this matter in the event you had any questions.

]

764112
Wastewater Hot 3-10-06

Email message text
Object type: [GW.MESSAGE.MAIL]
Item Source: [Received]
Message ID: [3C48427C.Demo-dom.Demo-PO.200.2000016.1.87D4D.1]
From: [Dennis Kahlie]
To: []
Subject: [Sewer 218 Closed Session Issue]
Creation date: [1/7/2002 12:14:02 PM]
In Folder: [Mailbox]
Attachments: None
Message: [
George,

In checking with Kelly to determine when the deferred sewer Prop 218 compliance issue would make it back on the closed session agenda, I concluded that you might be unclear as to why we need this issue resolved.

While there has been appellate litigation holding that Prop 218 does not apply to the setting of usage-based water rates, our attorneys have advised that until such time as a similar decision is reached with respect to the setting of usage-based sewer rates, we should continue to comply with its provisions in dealing with sewer rate issues to avoid any possibility of litigation adversely impacting current and prospective debt issuances for the sewer capital program. This is a policy question for mayor/council that we wouldn't be bringing up at this time except that it bears on how we finalize and present the results of the sewer cost of service study.

First, the mayor has expressed an interest in having a "lifeline" rate. If we continue to adhere to Prop 218, its proportional cost of service provision prohibits discounted rates subsidized by others. Second, adhering to the 45-day noticing provisions of Prop 218 means that it's unlikely that the study results can be voted on until after March 1st, when the first of the council-adopted 7.5% rate increases goes into effect. We'll be in a position to discuss the results sooner (probably mid-February), but we'd have to go back a second time to accomodate noticing, etc.

Upside, if we reverse course on dealing with Prop 218, the mayor can have his "lifeline" rate and we avoid going to council twice on cost of service. Downside, we'll give bond /disclosure counsel some heartburn, we'll have to disclose the change in policy in continuing disclosure on existing sewer debt and in our offering statements for the upcoming issuance this spring, thereby providing a litigation roadmap for Jarvis Taxpayers' or whoever else might be interested. Bottom line given the litigation risk, we thought this issue significant and complex enough to warrant closed session discussion. At the same time, we'll eliminate a potential impediment to getting the cost of service study recommendations adopted by resolving the "lifeline" issue before the report is finalized.

- D

]

EXHIBIT 5

Email message text
Object type: [GW.MESSAGE.MAIL]
Item Source: [Received]
Message ID: [3E67329F.CCP.TREASURE.100.1383633.1.4171.1]
From: [Dennis Kahlie]
To: [;Christine Ruess;CRuess@sandiego.gov;Kelly Salt;KSalt@sandiego.gov;Eric Adachi;EAdachi@sandiego.gov]
Subject: [Fwd: Re: Cost of service study-questions]
Creation date: [3/6/2003 11:35:56 AM]
In Folder: [COS Update]
Attachment File name: [c:\44923\EAdachi\7220.1-GW.MESSAGE.MAIL]
Message: [
FYI

]

292530 dup

092528P

273889

Wastewater Hot 3-15-06

Email message text
Object type: [GW.MESSAGE.MAIL]
Item Source: [Received]
Message ID: [3E67329F.CCP.TREASURE.200.2000016.1.2E612.1]
From: [Dennis Kahlie]
To: [;Keri Katz;KKatz@sandiego.gov;Leslie Devaney;LDevaney@sandiego.gov;Richard Mendes;RMendes@sandiego.gov;Scott Tulloch;STulloch@sandiego.gov;Bill Hanley;WHanley@sandiego.gov]
Subject: [Re: Cost of service study-questions]
Creation date: [3/6/2003 11:34:44 AM]
In Folder: [COS Update]
Attachment File name: [c:\44923\EAdachi\7220.1.1-Memo to Attorneys.doc]
Message: [
Keri,

The memo you requested is attached.

- D

>>> Keri Katz 03/05/03 04:17PM >>>
Good Afternoon,
Regarding Council member Frye's questions at NRC today, Dennis Kahlie has agreed to prepare a memo from financing services to my office answering the following questions:
1) What is the current status of the most recent cost of services study?
2) What is the time line for completion of this study?
3)What are the dates for the past cost of service studies?
I will then forward the information to the Council member's office. Additionally, pursuant to Richard's suggestion, I plan on talking to Leslie Devaney about this. In the meantime, however, I wanted to start working on this with Dennis since we only have a week to get the memo out.
Please let me know if you have any problems with me proceeding in this manner and if you have any questions.
Thanks,
Keri

]

273888
Wastewater Hot 3-15-06

CITY OF SAN DIEGO
MEMORANDUM

DATE: March 6, 2003

TO: Head Public Works Deputy City Attorney Keri Katz

FROM: Utilities Finance Administrator, Office of the City Treasurer

SUBJECT: INFORMATION REQUESTED RELATIVE TO UTILITY COST OF SERVICE STUDIES

Cost of service studies are complex engineering and economic analyses whose primary objectives are determining the cost of providing a service and allocating that cost to customers on a basis proportional to their use of that service. Numerous such studies have been performed on both the water and wastewater (sewer) utilities in the past, and two such studies are currently contracted for and in progress.

By e-mail dated March 5, 2003, you requested certain information relative to utility cost of service studies as reflected below:

Q. What is the status of the most recent cost of service study, and what is the schedule for its completion?

A. As noted above, both a water cost of service study and an update to the most recently completed wastewater cost of service study are currently in progress. The water study is scheduled for completion in the first week of June, 2003. The wastewater study update is scheduled for completion during the week of July 21st, 2003.

Q. What are the dates of past cost of service studies?

A. Previous cost of service studies of which I have knowledge, the dates of their issuance, and the firms by which they were performed, are as follows:

Water Studies

7/24/58	Roy A. Wehe
11/15/66	Wilsey & Ham
9/17/73	Brown & Caldwell

Water Studies (continued)

3/30/90	Brown & Caldwell
11/21/97	Pinnacle Consulting / Chester Engineers

Wastewater Studies

11/16/66	Wilsey & Ham
3/30/90	Brown & Caldwell
5/14/98	Pinnacle Consulting / Chester Engineers
5/01/02	Black & Veatch (Draft, requiring material updates, distributed to Mayor and Council in November, 2002.)

Should you, Councilmember Frye, or others have additional questions with respect to water / wastewater cost of service studies, please feel free to contact me directly, either by e-mail at dkahlie@sandiego.gov, or by phone at 619-235-5832.

D. H. KAHLIE

EXHIBIT 6

284513
Wastewater hot 03_01_06

Email message text
Object type: [GW.MESSAGE.MAIL]
Item Source: [Sent]
Message ID: [3FABB339.CCP.CITY_ATTY.100.16E696E.1.17923.1]
From: [Keri Katz]
To: [;Salt, Kelly;KSalt@sandiego.gov]
Subject: [Re: PUAC on Monday the 17th-cost of service study]
Creation date: [11/7/2003 2:59:05 PM]
In Folder: [Mail Box]
Attachment File name: [c:\44927city_atty\KKatz\31.1-TEXT.htm]
Message: [
Yes that's why we have to talk --Lets discuss on Wednesday

>>> Kelly Salt 11/06/03 04:30PM >>>
Hi, I have been at meetings outside of the office all day today. I will give you a call tomorrow (I'm telecommuting). Did you talk to Richard and discuss the closed session he wanted to have?

>>> Keri Katz 11/06/03 11:48 AM >>>
Kelly
We need to talk about the PUAC meeting on the 17th of this month.
They are going to discuss the cost of service study.....If possible please plan on attending ,
It start at 8;30 at Metro's big conference room.
Lets talk,
Keri
]

EXHIBIT 7

612197
Wastewater Hot 3-21-06

Public Utilities Advisory Commission
Monday, November 17, 2003
8:30 a.m. - 11:30 a.m.
Metro Operations Center II
9150 Topaz Way, San Diego, CA 92123

Documentation Included	Item	
No	1. Roll Call	Kathi Ward
	2. Approval of Minutes from 10/20/03	Chuck Spinks
No	3. Non-Agenda Public Comment**	
No	4. General Ledger Project	Ed Ryan
Yes	5. Sewer System Planning in Canyons	Halla Razak
No	6. MWWD General Monthly Update	Scott Tulloch
No	7. Water Department General Monthly Update	Larry Gardner
Yes	8. Cost of Service Presentation	Dennis Kahlie
No	9. Mandatory Reuse	Mike Bresnehan
	10. Committee Reports	
No	a. Water & Wastewater CIP Committee	Chuck Spinks
No	b. Water & Wastewater O&M Committee	Scott Chadwick
No	c. Water & Wastewater Service Delivery Committee	Lisa Briggs
	d. Special Issues Committee	Glen Schmidt
No	11. Legislative Update	Keri Katz
No	12. Commissioners' Comments	All

** This portion of the agenda provides an opportunity for members of the public to address the Commission. Comments are limited to three (3) minutes per individual. Please complete a Speaker's Slip in advance of the start of the meeting and give it to the Secretary.

NOTE: Any of the items listed on the Commission's agenda may be acted upon by the Commission.

For alternative format or disabled accommodations, please call Kathi Ward at 619/236-6750.

The next meeting will be on Monday, December 15, 2003 at 8:30 am at the same location.

EXHIBIT 8

292299
284117
Wastewater Hot 03-06-06

Email message text
Object type: [GW.MESSAGE.MAIL]
Item Source: [Sent]
Message ID: [3FBE2A70.CCP.CITY_ATTY.100.1627437.1.13ED2.1]
From: [Kelly Salt]
To: [;Katz, Keri;KKatz@sandiego.gov]
Subject: [Fwd: Cost of Service Study]
Creation date: [11/21/2003 3:08:32 PM]
In Folder: [Mail Box]
Attachment File name: [c:\44927city_atty\KSalt\737.1-GW.MESSAGE.MAIL]
Message: [
FYI- I got a voice mail the other day from a woman in Richard Opper's office (the law frim representing Kelco on the Cost of Service Study matter). She asked me for copies of a number of documents regarding the SRF loans and program guidelines, etc. Doug Sain's e-mail to Richard (attached) suggests that I was "uncooperative" with her but I merely explained to her that I don't have the documents that she was requesting, that she should contact Bill Hanley to get them, and that since she was requesting quite a few documents she should put the request in writing (see the next e-mail explaining this to Richard). Before I returned her call and discussed this with her, I had spoken to Richard and gave him a heads up about her call and that I was going to suggest she call Bill. I thought you might want to know what is going on in the event Doug contacts you.

]

Email message text
Object type: [GW.MESSAGE.MAIL]
Item Source: [Received]
Message ID: [3FBE2A70.CCP.CITY_ATTY.200.200000A.1.18D1A4.1]
From: [Richard Mendes]
To: [;Salt, Kelly;KSalt@sandiego.gov;Loveland, George;GLoveland@sandiego.gov;Hanley, Bill;WHanley@sandiego.gov]
Subject: [Fwd: Cost of Service Study]
Creation date: [11/21/2003 10:52:37 AM]
In Folder: [Mail Box]
Attachment File name: [c:\44927city_atty\KSalt\737.1.1-TEXT.htm]
Attachment File name: [c:\44927city_atty\KSalt\737.1.2-GW.MESSAGE.MAIL.Internet]
Message: [
fyi-I'll be out next week but I'll speak with you the week after Thanksgiving
]

Email message text
Object type: [GW.MESSAGE.MAIL.Internet]
Item Source: [Received]
Message ID: [3FBDEE7A.CCP.CITY_ATTY.200.200000A.1.18D049.1]
From: ["Doug Sain" <Doug@SainCommunications.com>]
To: [;linda@envirolawyer.com;linda@envirolawyer.com;Mendes, Richard;RMendes@sandiego.gov]
Subject: [Cost of Service Study]
Creation date: [11/21/2003 10:23:30 AM]
In Folder: [Mail Box]
Attachment File name: [c:\44927city_atty\KSalt\737.1.2.1-TEXT.htm]
Attachment File name: [c:\44927city_atty\KSalt\737.1.2.2-Mime.822]
Message: [
Hi Richard,

Could you please direct MWWD staff and the City Attorney's office to cooperate with CP Kelco and ISP Alginates' effort to complete a due diligence study of the City's State and Federal contractual commitments and regulatory compliance regarding the wastewater cost allocation matter identified in the Wastewater Cost of Service Study? Our effort is directed at trying to gain compliance for the City's existing cost allocation methods; however, the City Attorney's office is requesting our attorney file a public information request to gain access to all of the City's State and Federal agreements which are cited as the reason for necessitating the addition of a COD charge in the cost allocation structure.

While our attorney, Richard Opper, is certainly able to file a public information request, I would appreciate your assistance by your asking MWWD staff and the City Attorney's office to cooperate with our inquiries, so as to avoid any perception of "stonewalling" or "antagonizing" our effort. In particular, the assistance of Bill Hanley and Kelly Salt would be much appreciated. We look forward to working with you to suggest City Manager recommendations that avoid the disruptive recommendations of the Black & Veatch report and instead achieve regulatory compliance while minimizing rate impacts on City ratepayers.

Doug

--
Doug Sain
Sain Communications, Inc.
707 Broadway Avenue, 19th Floor

284115
Wastewater Hot 03-06-06

P.O. Box 124624
San Diego, CA 92112-4624
Tel: 619-232-6558
Fax: 775-418-9515

]

EXHIBIT 9

284527
Wastewater hot 03_01_06

Email message text
Object type: [GW.MESSAGE.MAIL]
Item Source: [Received]
Message ID: [3FD45CE0.CCP.CITY_ATTY.200.2000016.1.FE2A7.1]
From: [Dennis Kahlie]
To: [;Katz, Keri;KKatz@sandiego.gov;Salt, Kelly;KSalt@sandiego.gov]
Subject: [SWRCB Response]
Creation date: [12/5/2003 10:49:55 AM]
In Folder: [Mail Box]
Attachment File name: [c:\44927city_atty\KKatz\404.2.1-TEXT.htm]
Attachment File name: [c:\44927city_atty\KKatz\404.2.2-Response To Blair Letter of 11-26-03.doc]
Message: [
Keri,

I understand that you've seen the 90-day letter recently received from SWRCB on rate structure compliance issues. Pat Frazier and George Loveland have asked that I prepare a response for the manager's signature and discuss with you.

A draft of that response, with a few holes left to be filled (and absent the attachments) is attached. Inclusive of its 16 attachments, the end product should do a creditable job of filling a 4 or 5 inch ring binder, and provide a comprehensive record of our prior and current attempts at achieving compliance.

- D

]

284526
Wastewater hot 03_01_06

December ??, 2003

Mr. Ronald R. Blair, Sanitary Engineering Associate
Division of Financial Assistance
State Water Resources Control Board
1001 I Street
Sacramento, California 95814

Reference: Your letter of November 26, 2003 (Attachment #1)

Dear Mr. Blair:

Thank you for your letter of November 26th, seeking documentation of the City of San Diego's (City) implementation of the wastewater revenue program approved by your office on September 17th, 1991 and related matters. Via the following narrative and numerous attachments, I will document the City's past and ongoing efforts to achieve full compliance with the user charge requirements of the Clean Water Grant and State Revolving Fund (SRF) loan programs.

IMPLEMENTATION OF THE SEPTEMBER 1991 APPROVED PLAN

The wastewater rates and charges contained in the September 1991 approved plan were developed by the consulting engineering firm of Brown & Caldwell and presented in a wastewater rate study and financial plan and revenue program document dated March 30, 1990 (Attachment #2). Those rates and charges, which were the basis for a five-year financing plan, were adopted by the City Council pursuant to Resolution Number R-275941, on June 19, 1990 (Attachment #3).

Because the City was (and is) operating a regional transportation, treatment and disposal system (the Metro System), Clean Water Grant regulations provided that final approval of the City's revenue program could not be granted until each client agency (collectively, the Participating Agencies) of the Metro System had also prepared and received approval of their individual revenue plans and sewer use ordinances. As you know, this did not occur until September of 1991, when the city of Chula Vista's plan and ordinance were approved by you, as evidenced by your letter to that effect dated September 18, 1991 (Attachment #4).

EVOLUTION IN COST ALLOCATION STANDARDS APPLICABLE TO THE PLANS

At the time of their final approval in September of 1991, the revenue plans of the City and the Participating Agencies allocated costs to the parameters of flow and suspended solids (SS) only, which was consistent with the prescribed approach to be taken by agencies operating or utilizing a system providing primary treatment of effluent.

The City recognized that at such time that it brought secondary treatment facilities on line as component parts of the Metro System, it would become necessary to incorporate an organics parameter in its cost allocation methodology. In recognition of that fact, the City sought and received the approval of your predecessor, Mr. Frank Peters, for its plan to utilize Chemical Oxygen Demand (COD) in lieu of Biochemical Oxygen Demand (BOD_5) for that purpose in July of 1989 (Attachments #5 and #6).

IMPLEMENTATION OF THE NEW STANDARDS

In anticipation of bringing the secondary/tertiary treatment-capable North City Water Reclamation Plant on line in 19???, the City began a systematic approach to incorporating the COD parameter, first in its Metro System and, subsequently, its Municipal billing structure.

Metro System – In Compliance as of September 30, 1998

Since its construction in the early 1960's, the Metro System's Participating Agencies and the City were allocated their respective shares of operating and related costs based only on flow. This being the case, the incorporation of the SS and COD billing parameters required modifications to the Regional Wastewater Disposal Agreements (Agreements) previously entered into between each Agency and the City. Because of the numerous other changes to the Agreements necessitated by the addition of new capital facilities to meet National Pollution Discharge Elimination System (NPDES) permit and growth-related requirements, it was collectively decided by the City and Participating Agencies that the billing structure changes would be addressed in the context of a comprehensive revision to the Agreements.

Once the negotiation process was complete, new Agreements were executed by each of the Participating Agencies and the City which provided for billing on the basis of flow, SS and COD. A copy of the new Agreement was forwarded to you on August 31st, 1998 (Attachment #7) and received your approval on September 30th of that year (Attachment #8)

Municipal System – Groundwork Completed July 10, 2001

In the fall of 1999, the City Council directed the City Manager to prepare a wastewater cost of service study with the active participation of a Stakeholders' Group to be appointed by then-mayor Susan Golding. The objectives of Stakeholder participation were to insure that ratepayer representatives were aware of the challenges and complexities inherent in the rate setting process, and that community values were reflected in structuring recommendations.

In March of 2000, the consulting engineering firm of Black & Veatch was selected to perform the technical study, with the firm of Katz & Associates performing facilitation and logistical

support services for City staff, Black & Veatch and the Stakeholders' Group membership, which was appointed the following July, and began work that September.

The Stakeholders' Group met with City and consultant staff a total of ten times between September 14, 2000, and May 3, 2001, a period marked by a change in mayoral administration and turnover in three council districts. Over the course of that time, Stakeholders received detailed presentations and entered into spirited dialogue about various issues related to cost allocation methodology, rate structures and permit requirements, and the impact of alternative rate structuring options on various user classifications and individuals. Shortly after its final meeting, the Sewer Cost of Service Stakeholders' Group issued its *Final Report* (Attachment #9), incorporating numerous recommendations with respect to base fees, residential usage caps and rate structuring for commercial and industrial dischargers.

As you may recall, cost allocation methodology has always been a contentious issue among the City's organics dischargers, proving once again to be the case during Stakeholder deliberations as well. Stakeholder concern as to the approvability of alternative cost allocation methodologies proposed by a "subgroup" of Stakeholders resulted in a May 22, 2001 letter to you requesting review of the consultant's recommended functional design methodology, a Stakeholder-proposed "straight TSS (STSS) method", and a modified STSS approach offering internal consistency (Attachment #10). In your response, dated July 10, 2001 (Attachment #11), you indicated that the functional design methodology previously reviewed and approved by you (see Attachments #7 & #8) for Metro System billings was utilized by numerous California agencies, and would be approved for municipal use. At the same time, you cautioned that the STSS and modified STSS methods would not be approved, because of their failure to allocate any Point Loma primary treatment costs to the COD parameter.

Municipal System – Current Status

Given the aforementioned changes in administration and the intensity of lobbying efforts on the part of certain organics dischargers, municipal compliance is not yet an accomplished fact. Nonetheless, material progress has been made, and Council review and adoption of the requisite changes to effect compliance has been scheduled.

In October of this year, Black & Veatch completed an update to the cost of service study initially prepared with Stakeholder input in 2001 (Attachment #12), which was transmitted to the Mayor and Council members on October 17th (Attachment #13). This comprehensive revision of their earlier functional design-based work incorporates the most recent data available, yielding a system of rates and charges which are approvable by SWRCB and designed to be implemented at the beginning of fiscal year 2005.

Pursuant to his commitment to public review and involvement, Mayor Dick Murphy established a Public Utilities Advisory Commission (PUAC) on ?????????. PUAC's role is to review, consider and make recommendations to the Mayor and Council on material issues affecting the City's water and wastewater utilities. Consistent with that commitment, the updated wastewater cost of service study was transmitted to PUAC for review on October 20th, 2003 (Attachment #14).

An initial, overview presentation of the wastewater study, and its companion water study, was made at PUAC's November 17th, 2003 meeting (Attachment 15). At that time, the PUAC membership was made aware of the City's Clean Water Grant / SRF loan compliance obligations (Attachment 16), and responsibility for detailed review of the wastewater study was assigned to PUAC's Water and Wastewater Service Delivery Committee. The Committee will schedule a series of evaluation sessions, the first of which is already set for December 17th, 2003. Once PUAC has completed its work, an implementation report will be prepared by City staff and presented first to the Council's Natural Resources and Culture (NR&C) Committee, which has oversight responsibility for wastewater matters, and then to the full Council membership for discussion and adoption on ???????????

SUMMARY AND CONCLUSION

As a prior recipient of both Clean Water Grants and SRF loans for its wastewater projects, the City appreciates the magnitude of the financial benefits derived by both Metro System and City ratepayers, and recognizes the ultimate need for and desirability of compliance with the "proportionate to use" billing requirements of both programs at the municipal level. At the same time, given the financial consequences of the required changes for some ratepayers, it has been necessary to move cautiously toward that goal.

As noted above, the mayor and council are committed to a hearing of this matter on ????????, subsequent to its review by PUAC and NR&C. Such a process will avail interested parties of the opportunity to make their feelings known in one or more forums, hopefully leading to the adoption of a new municipal rate structure that complies fully with the requirements of SWRCB and the Clean Water Act. We would appreciate your review of this letter and its attachments, and an indication of your support for our anticipated schedule for achieving compliance at your earliest convenience.

Sincerely yours,

MICHAEL T. UBERUAGA
City Manager

DHK

Attachments:

1. SWRCB letter dated November 26, 2003
2. Brown & Caldwell Cost of Service Study, dated March 30, 1990
3. Council Resolution Number R-275941, June 19, 1990
4. SWRCB letter indicating approval, dated September 18, 1991
5. Letter to F. Peters re COD, July 19, 1989
6. Memo to file re response of F. Peters, July 28, 1989
7. Copy of Wastewater Disposal Agreement forwarded to SWRCB for approval, August 31, 1998
8. Letter of approval from SWRCB, dated September 30, 1998
9. Stakeholders' Group final report, dated May 3, 2001
10. Letter to SWRCB re alternative allocation methodologies, dated May 21, 1991

11. SWRCB response re alternative allocation methodologies, dated July 10, 1991
12. Black & Veatch Cost of Service Study, dated October, 2003
13. Memorandum of transmittal to mayor and council, dated October 17, 2003
14. Memorandum of transmittal to PUAC, dated October 20, 2003
15. PUAC Agenda, meeting of November 17, 2003
16. PowerPoint presentation to PUAC, November 17, 2003

EXHIBIT 10

284520
574574
WW Hot 02_24_06

Email message text
Object type: [GW.MESSAGE.MAIL]
Item Source: [Received]
Message ID: [3FD07519.CCP.MANAGER.100.1707275.1.17136.1]
From: [Dennis Kahlie]
To: [;Katz, Keri;KKatz@sandiego.gov;Frazier, Patricia;PFrazier@sandiego.gov]
Subject: [Re: SWRCB Response]
Creation date: [12/5/2003 12:07:47 PM]
In Folder: [cost of srv]
Attachment File name: [c:\44927manager\PFrazier\8685.1-TEXT.htm]
Message: [
OK, thanks.

- D

>>> Keri Katz 12/05/03 11:52AM >>>

Dennis please work with Kelly on this.
She has the lead from our office.
Keri

>>> Dennis Kahlie 12/05/03 10:49AM >>>

Keri,

I understand that you've seen the 90-day letter recently received from SWRCB on rate structure compliance issues. Pat Frazier and George Loveland have asked that I prepare a response for the manager's signature and discuss with you.

A draft of that response, with a few holes left to be filled (and absent the attachments) is attached. Inclusive of its 16 attachments, the end product should do a creditable job of filling a 4 or 5 inch ring binder, and provide a comprehensive record of our prior and current attempts at achieving compliance.

- D

]

EXHIBIT 11

284538p
284140
Wastewater Hot 03-06-06

Email message text
Object type: [GW.MESSAGE.MAIL]
Item Source: [Sent]
Message ID: [3FD47DE4.CCP.CITY_ATTY.100.1627437.1.1425D.1]
From: [Kelly Salt]
To: [;Katz, Keri;KKatz@sandiego.gov;Girard, Les;LJGirard@sandiego.gov]
Subject: [Re: Fwd: SWRCB Response]
Creation date: [12/8/2003 1:34:28 PM]
In Folder: [Mail Box]
Attachments: None
Message: [
No, there are no regulations that govern this situation. We are out of compliance with our grant and SRF loan conditions. I belive that his deadline was to give us time to get a rate case in place.

>>> Keri Katz 12/08/03 01:24PM >>>
Kelly is a "90 day letter" the first step in some sort of compliance order? Is it in any state regulations? Any thoughts on giving the Mayor and Council an FYI on this one? Perhaps an e-mail. I hate for them to be upset we didn't tell them.
Just a thought,,
Keri

>>> Kelly Salt 12/08/03 12:09PM >>>
Les, I will forward a copy of the SWRCB letter to you via interoffice mail, but the gist of the letter is that they want to know why the City hasn't complied with the terms and conditions of our SRF loan agreements and Clean Water grant conditions that the City implement a wastewater rate system approved by their office. They have requested that we provide them with the requested documents within 90 days of receipt of the letter. Attached is the response that Dennis has prepared to the letter and that I am reviewing. I can also forward to you the closed session memo I did on what is required of us under the grant and loan agreements if you need to see that again.

The Cost of Service Study (CSS) has been presented in form to the PUAC and is being reviewed by one of its subcommittees. After the subcommittee has reviewed it it will go back to the full PUAC. It may go to NR&C, but the Mananger's office is still reviewing whether to go to Committee or directly to Council. Dennis has informed me that John Kern has indicated that he doesn't want this to go to Council until after the primary. To complicate matters further, since there will be rate increases if the CSS is adopted, a Prop 218 notice will need to be sent to ratepayers at least 45 days in advance of the public hearing implementing the proposed rate increase. The timeline is very fluid (forgive the pun) right now. I have told Dennis that because of the 218 notice, they may want to have the Council approve the CSS separately and then conduct the 45-day public hearing on the rate increases when they know that the Council is on board with the rate structure as proposed in the CSS. I have recommended this primarily because the Council may not adopt the CSS recommendations in their entirety (eg, because of pressure from Kelco and the restaurant lobby, the council may shift more of the cost on the base rate, as they did at the hearing on the water rate increases). If that happens they would have to renotice pursuant to 218 the hearing with the altered rate structure. Dennis will be talking to Pat and George to see how they want to proceed. Let me know if you have any questions. After I have given my comments to Dennis I will forward to you and Keri the revised response in case you have any input.

EXHIBIT 12

284530
Wastewater hot 03_01_06

Email message text
Object type: [GW.MESSAGE.MAIL]
Item Source: [Sent]
Message ID: [3FD45F79.CCP.CITY_ATTY.100.16E696E.1.18141.1]
From: [Keri Katz]
To: [;Salt, Kelly;KSalt@sandiego.gov;Girard, Les;LJGirard@sandiego.gov]
Subject: [Re: Fwd: SWRCB Response]
Creation date: [12/8/2003 11:24:41 AM]
In Folder: [Mail Box]
Attachment File name: [c:\44927city_atty\KKatz\409.1-TEXT.htm]
Message: [
Yes we did and it is on its way to Council--just hasn't made it yet! Not sure what the hold up is..I talk to Kelly and ask her to update you .
Keri

>>> Les Girard 12/08/03 11:21AM >>>
Thanks. I thought we did a cost of service study. What happened?

>>> Keri Katz 12/08/03 11:13AM >>>

FYI -
On Friday I forgot to brief on this. Apparently, the state water resources control board is asking why we have not complied with the State's loan requirements(cost of service study)for the SRF loans for our sewer system. We are in the process of answering questions. This is a potentially serious concern since they could take a way our Grant/loans or fine us...
Kelly is working with Dennis on this. We will keep you up to date .
Keri
]

EXHIBIT 13

765841
Wastewater Hot 3-10-06

Email message text.
Object type: [GW.MESSAGE.MAIL]
Item Source: [Received]
Message ID: [40F3BD19.Demo-dom.Demo-PO.100.16E336C.1.2B8C.1]
From: [Keri Katz]
To: []
Subject: [Fwd: Re: Sewer Cost of Service Study]
Creation date: [6/2/2004 4:43:08 PM]
In Folder: [Disclosure Related]
Attachment File name: [E:\Output\LJGirard1\4974.1-TEXT.htm]
Attachment File name: [E:\Output\LJGirard1\4974.2-GW.MESSAGE.MAIL]
Message: [
FYI------
]

765840
Wastewater Hot 3-10-06

Email message text
Object type: [GW.MESSAGE.MAIL]
Item Source: [Received]
Message ID: [40BDF58C.Demo-dom.Demo-PO.200.2000004.1.1EBEBD.1]
From: [Ted Bromfield]
To: []
Subject: [Re: Sewer Cost of Service Study]
Creation date: [6/2/2004 4:06:44 PM]
In Folder: [Disclosure Related]
Attachments: None
Message: [
All: 11:00 is fine; I worked this a.m. with Bill Hanley and Alan Langworthy and have written a scripted motion for the Mayor to direct the Manager to study and return with "Kelco" options. Have that for review upon request. T.

>>> Keri Katz 06/02/04 01:24PM >>>
I am telecommuniting tommorrow how about a telephone call at 11:00 AM? I call Kelly's office and it should last no more then 30 minutes?
Ted Ok?

>>> Kelly Salt 06/02/04 01:14PM >>>
I can't do it at 1:30. How about this afternoon or tomorrow after 3:00?

>>> Keri Katz 06/02/04 12:33PM >>>
Yikes` I have Heads at 10:00?
Can we do it at 1;30???????

>>> Michelle Barrett for Ted Bromfield (Michelle Barrett) 06/02/04 11:03AM >>>
This urgent attorney meeting is needed before next week's Council meeting and is a "red arrow" (high profile) matter. It would be in Conference Room #5, following the Contracts Practice Group meeting.

]

EXHIBIT 14

765849
Wastewater Hot 3-10-06

Email message text
Object type: [GW.MESSAGE.MAIL]
Item Source: [Sent]
Message ID: [410E6590.Demo-dom.Demo-PO.100.16E336C.1.2C54.1]
From: [Les Girard]
To: []
Subject: [Fwd: Re: Sewer Cost of Service Study]
Creation date: [6/2/2004 5:16:03 PM]
In Folder: [Disclosure Related]
Attachment File name: [E:\Output\LJGirard1\4978.1-TEXT.htm]
Message: [
Yes, please have them send me an e-mail. Thanks.

>>> Keri Katz 06/02/04 04:09PM >>>

WHY NOT YOU DO EVERY THING ELSE~;-)
Do you want me to have Kelly give you an e-mail with our legal theory ----
Both she and Ted will be at the closed session.
Just let me know,
Keri

>>> Les Girard 06/02/04 04:03PM >>>
Thanks. I'm not sure who should take the lead. Perhaps I should.

>>> Keri Katz 06/02/04 03:50PM >>>

Ted 's motion for the Mayor is to direct the Manager to study other treatment options for Kelco. The plan is the new rate structure should be adopted.....
Do you want Ted or Kelly to take the lead in closed session regarding the UCAN claim?

>>> Les Girard 06/02/04 03:44PM >>>
They can't continue this. What is going on?

>>> Keri Katz 06/02/04 03:43PM >>>
FYI------
]

765847P